

## CHAPTER 4

### Table of Contents

<i>Paragraph</i>	<i>Page</i>
<b>4-000 General Audit Requirements</b>	
4-001 Scope of Chapter .....	401
<b>4-100 Section 1 --- FAO Coordination with Contract Administration Personnel</b>	
4-101 Introduction .....	401
4-102 Coordination with Contractor and Government Contract Administration Personnel .....	401
4-103 Acknowledgment/Notification Letter .....	401
Figure 4-1-1 Example Acknowledgment Letter .....	403
Figure 4-1-2 Example Notification Letter .....	404
Figure 4-1-3 Example Acknowledgement Letter Application of Agreed-Upon Procedures .....	405
4-104 Negotiation Memorandum and Findings on Appeals .....	407
<b>4-200 Section 2 --- Coordination with Contractor Internal and External Auditors</b>	
4-201 Introduction .....	408
4-202 Relationships with Contractor Internal and External Auditors .....	408
4-202.1 Coordinated Audit Planning .....	408
4-202.2 Access to DCAA Working Papers .....	409
4-202.3 Coordinated Audit Matrix .....	409
4-203 DCAA Response to Accounts Receivable Confirmation Requests from CPA Firms .....	409
<b>4-300 Section 3 --- Conferences With the Contractor (Entrance, Interim, and Exit) on Audit Plans and Results</b>	
4-301 Introduction .....	411
4-302 Contractor Conferences - Entrance .....	411
4-302.1 General Procedures for Entrance Conferences .....	411
4-302.2 Special Considerations for Entrance Conferences on Major Operations Audits .....	412
4-302.3 Confirming Letter on Certain Major Assignments .....	412
4-302.4 Resident Working Arrangements for Entrance Conferences .....	412
4-303 Contractor Conferences - Interim .....	413
4-303.1 General Procedures for Interim Conferences .....	413

<i>Paragraph</i>	<i>Page</i>
4-303.2 Incurred Cost Submissions.....	414
4-303.3 Operations Audits – Interim Conferences .....	414
4-304 Contractor Conferences -- Exit.....	414
4-304.1 General Procedures for Exit Conferences.....	414
4-304.2 Price Proposals .....	415
4-304.3 Postaward Audits of Cost or Pricing Data for Possible Defective Pricing .....	415
4-304.4 Incurred Cost Submissions.....	416
4-304.5 Operations Audits – Exit Conferences.....	416
4-304.6 Cost Accounting Standards Audits .....	417
4-304.7 Litigation Support .....	417
<b>4-400 Section 4 --- Audit Working Papers</b>	
4-401 Introduction.....	419
4-402 General.....	419
4-403 Format and Contents of Working Papers .....	419
Figure 4-4-1 Standard Working Paper Format and Indexing .....	424
Figure 4-4-2 Administrative Working Papers.....	425
Figure 4-4-3 Supplemental Index to Audit Working Papers Electronic Files ....	426
4-404 Working Papers - Agenda Sheet .....	426
4-405 Working Papers Files .....	426
4-405.1 Permanent File .....	426
4-405.2 Current File .....	427
4-406 Copies of Contractor Data in Working Papers.....	427
4-407 Computer-Aided Working Papers .....	428
4-408 Computer-Aided Audit Applications.....	431
4-409 Revisions to the Audit Working Papers after the Audit Report is Issued.	432
<b>4-500 Section 5 --- Using Information Technology (IT) in Contract Auditing</b>	
4-501 Introduction.....	435
4-502 Policy on Use of IT .....	435
4-502.1 General Criteria for Using IT in Audit Applications .....	435
4-502.2 Use of Contractor IT .....	436
4-502.3 Cooperation with Internal and Independent Auditors .....	436
4-503 Organizational Support of Auditing Using IT.....	437
4-503.1 Regional IS Auditors and Computer Specialists .....	437
4-503.2 Technical Support Branch .....	437

**January 2003**

**4(3)**

*Paragraph*

*Page*

4-503.3 IT Related Training.....	437
4-504 IT Audit Tools.....	437
4-504.1 Generalized Audit Software.....	437
4-504.2 Application Software Tracing and Mapping.....	437
4-504.3 Audit Expert Systems.....	438
4-504.4 Test Data.....	438
4-504.5 Utility Software.....	438

**4-600 Section 6 --- Audit Sampling**

4-601 Introduction.....	439
4-602 Sampling .....	439
4-603 Scope and Degree of Testing .....	439
4-604 Method of Selecting Sample Items.....	440
4-605 Sampling Policy .....	441
4-606 Sampling Software .....	441

**4-700 Section 7 --- Responsibilities for Detection and Reporting of Suspected Irregularities**

4-701 Introduction.....	442
4-702 Suspected Fraud and Unlawful Activity --- General .....	442
4-702.1 General.....	442
4-702.2 Auditor Responsibilities for Detecting and Reporting Fraud..	442
4-702.3 Fraud Indicators and Audit Procedures for Uncovering Fraud .....	444
4-702.4 Procedures for Referring Suspicions.....	444
4-702.5 Audit Activities Subsequent to Referral --- Continuing Audits.....	445
4-702.6 Investigative Support Responsibilities .....	447
4-702.7 Control of Documents Obtained Under Inspector General or Grand Jury Subpoenas and Civil Investigative Demands .....	448
4-702.8 Audit Reports Involving Alleged Subcontractor Fraud.....	449
4-703 Suspected Contractor Provision of Improper Gifts/Gratuities to Government Personnel .....	450
4-704 Suspected Violations of the Anti-Kickback Act (41 U.S.C. 51 to 58).....	451
4-704.1 General .....	451
4-704.2 Examples of Questionable Practices .....	451

<i>Paragraph</i>	<i>Page</i>
4-704.3 Audit Responsibilities.....	451
4-704.4 Referral Requirements .....	451
4-705 Suspected Anticompetitive Procurement Practices .....	451
4-706 Suspected Illegal Political Contributions .....	452
4-706.1 The Statute .....	452
4-706.2 Methods of Channeling Inappropriate Expenditures.....	452
4-706.3 Audit Responsibilities.....	452
4-706.4 Referral Requirements .....	453
4-707 Voluntary Disclosure Program.....	453
4-707.1 General.....	453
4-707.2 Audit Responsibility – Voluntary Disclosure.....	454
4-707.3 Audit Reports.....	454
4-708 Obstruction of Audit .....	455
4-709 Qui Tam Actions Under the False Claims Act .....	455
4-710 Defense Hotline.....	455
4-711 Evaluating Contractor Compliance with Administrative Suspension and Debarment Agreements .....	457
4-7S1 Supplement - Public Law 99-634, "Anti-Kickback Enforcement Act of 1986" .....	459
Figure 4-7-1 Pro Forma Cautionary Transmittal Memorandum .....	461
Figure 4-7-2 Suspected Irregularity Referral Form .....	462
Figure 4-7-3 Examples of Characteristics and Types of Activity Associated with Illegal Expenditures and Acts for Specific Audit Areas .....	464
<b>4-800 Section 8 --- Special Reporting of Unsatisfactory Conditions</b>	
4-801 Introduction.....	465
4-802 Voluntary Refunds for "Windfall Profits" .....	465
4-802.1 Introduction.....	465
4-802.2 Audit Responsibility – Voluntary Refunds .....	465
4-802.3 Audit Procedures .....	465
4-802.4 Audit Reports.....	465
4-803 Unsatisfactory Conditions (Serious Weaknesses, Mismanagement, Negligence, etc.) on the Part of Contractor or Government Personnel .....	465
4-803.1 Introduction.....	465
4-803.2 Examples of Questionable Practices .....	465
4-803.3 Audit Responsibilities.....	466

<b>January 2003</b>	<b>4(5)</b>
<i>Paragraph</i>	<i>Page</i>
4-803.4 Headquarters Reporting Requirements .....	466
<b>4-900 Section 9 --- Requesting Audit Guidance -- Regional Offices and Headquarters</b>	
4-901 Introduction.....	468
4-902 Obtaining Guidance .....	468
4-902.1 Definition.....	468
4-902.2 Background and General Responsibilities .....	468
4-902.3 Requirements for Feedback to Headquarters .....	468
<b>4-1000 Section 10 --- Relying Upon the Work of Others</b>	
4-1001 Introduction.....	470
4-1002 General.....	470
4-1003 Work Performed by Others .....	470
4-1004 Deciding Whether to Rely on the Work of Others .....	470
4-1004.1 General Evaluation Criteria .....	470
4-1004.2 Evaluation of Competency, Independence, and Objectivity .	471
4-1004.3 Evaluation of Work Product.....	472
4-1005 Documentation Requirements.....	472
4-1006 Referencing the Work of Others in Audit Reports.....	473
4-1006.1 Technical Specialists .....	473
4-1006.2 Part of an Audit Performed by Other Auditors .....	473



## CHAPTER 4

## 4-000 General Audit Requirements

## 4-001 Scope of Chapter

This chapter presents general guidance and basic auditing concepts and techniques

to assist the auditor in accomplishing the objective of contract auditing. Amplification of this guidance will be found in later chapters and appendixes.

## 4-100 Section 1 --- FAO Coordination with Contract Administration Personnel

## 4-101 Introduction

This section presents guidance on general coordination with procurement and contract administration personnel.

cussions should be informal and conducted with an objective of mutual benefit.

c. In the case of visits to branch offices, it is contemplated that contacts would ordinarily be limited to contractor representatives at suboffices visited and government contract administration offices in the same locality as the branch offices or suboffices visited.

## 4-102 Coordination with Contractor and Government Contract Administration Personnel

a. The maintenance of effective communications and interface with the people with whom DCAA is involved in day-to-day operations is an important aspect of the audit function and is referenced in various sections of CAM dealing with operational auditing matters.

b. Periodic visits are made to various field audit offices by DCAA regional personnel (RD, DRD, RAM) in conjunction with reviews of the adequacy and status of audits performed by such FAOs. Occasional visits are also made to FAOs by members of the DCAA Headquarters staff in connection with their assigned duties. In view of the importance of effective communication, regional and Headquarters personnel should, during visits to FAOs, make a reasonable attempt to arrange for meeting with appropriate contractor and government contract administration officials. The primary purpose of such meetings is to provide contractor and government representatives with an opportunity to express their views on relationships with DCAA and any significant developments or problems where DCAA may be involved or be able to provide assistance. In addition, it is expected that significant audit matters and problems requiring the cooperation or assistance of contractor or government contract administration personnel would be discussed at these meetings. Dis-

## 4-103 Acknowledgment/Notification Letter

a. Correspondence with our audit customers is critical to coordinate and communicate our services effectively. Correspondence at the beginning of an audit should reflect our understanding of the customer's specific needs and summarize the audit services we intend to perform. The FAO should electronically transmit an acknowledgment letter in a timely manner in response to requests for audit services received from a customer (i.e., demand audits). An example acknowledgment letter is included in Figure 4-1-1. Requirements for acknowledgements of agreed-upon procedures engagements are discussed in paragraph 4-103d., below. The FAO should also electronically transmit notification letters to the planned recipient(s) of our audit reports for self-initiated audits (e.g., incurred cost audits, postaward audits, and internal control system audits). An example notification letter is included in Figure 4-1-2.

b. The suggested contents for acknowledgment/notification letters are as follows:

- Assignment Identification. Identify DCAA's assignment number for the audit and information to identify the customer's request for audit, in the case

of a demand audit, or the contractor's submission, in the case of a self-initiated audit.

- **Audit Scope.** Briefly describe the scope of audit and list the audit objectives and/or key audit procedures in bullet format.
- **Opportunity for Interaction.** Invite the customer to contact DCAA if the audit scope will not fully meet his/her objectives.
- **Technical Assistance.** If technical assistance is needed to perform a complete audit, incorporate the request into the letter (following the guidance in Appendix D) - See Figure 4-1-1 for an example.
- **In-process Communications and Report Date.** Provide the planned completion date for the audit and inform the customer that we will keep him/her informed of significant issues that may arise during the audit.

c. The acknowledgment/notification letter will usually be issued after the risk assessment/preliminary review section of the audit is completed. In the case of demand audits, this should be performed as quickly as possible after receipt of the audit request (a rule of thumb is five days). Should the auditor be unable to prepare the acknowledgment letter within a short time after receipt of the audit request, DCAA should issue a brief acknowledgment of the request and follow this up with an expanded letter, containing the elements in 4-103b, as quickly as possible.

d. Agreed-upon procedures: DCAA is authorized to accept agreed-upon procedures engagement requests for any financial-related assignment if (1) meaningful measurement criteria such as FAR, DFARS, CAS, GAAP, or other relevant

standards exist, and (2) the requestor and DCAA agree as to the procedures to be applied. Auditing standards require that the auditor establish a clear understanding regarding the terms of the engagement. DCAA auditors should accomplish this through an acknowledgement letter tailored to the specific procedures agreed upon for the assignment. If the initial request is unclear, the acknowledgement letter should not be issued until after DCAA and the requestor have discussed the requirements further and have reached an understanding of the procedures to be applied.

The following information should be included in the acknowledgement:

- Nature of engagement (i.e., an application of agreed-upon procedures).
- Identification of the contractor documentation to be evaluated and the fact the contractor is responsible for the contents.
- Identification of the specified users of the report.
- Confirmation of requestor's responsibility for the sufficiency of procedures.
- Responsibility of DCAA to perform in accordance with applicable professional standards.
- Listing of agreed-upon procedures and assessment criteria.
- (If applicable) Assistance to be provided to DCAA by requestor.
- (If applicable) Involvement of any specialists from outside of DCAA.
- Disclaimers expected to be included in the report.
- Restrictions on use of report.

Figure 4-1-3 is an example of an acknowledgment letter for agreed-upon procedures.



January 2003

403  
Figure 4-1-1

**Figure 4-1-1**  
**Example Acknowledgment Letter**

October 26, 20XX

MEMORANDUM FOR CONTRACTING OFFICER, DEPARTMENT OF THE AIR FORCE  
AIR LOGISTICS CENTER, 123 ROAD  
CITY, STATE 12345-6789

SUBJECT: Request for Audit of ABC Company  
Prime Contract Proposal for Systems Support  
REFERENCE: RFP No. WAFB12-XX-R-0097

We have received your request for audit services dated October 21, 20XX, for an audit of ABC Company's proposal, dated September 27, 20XX, submitted in response to RFP No. WAFB12-XX-R-0097. This is a firm-fixed-price proposal in the amount of \$11,443,450. We have established assignment number 1234-20XXB21000001 to audit this proposal.

The scope of our services will be based on auditor judgment, risk assessment and your specific needs, as we discussed on October 22, 20XX. During this examination we will perform the following procedures:

- Compare proposed labor hours to current plant-wide labor standards and evaluate the reasonableness of the proposed improvement curve applications.
- Evaluate the proposed labor rates.
- Verify that the proposed direct labor and indirect expense rates compare favorably with our recent audit of the forward pricing rates.
- Evaluate the contractor's cost analysis of the major subcontractor's proposal and request any needed assist audit.

As discussed with Ms. Molly Wilson, Industrial Engineer on October 22, 20XX, we need technical assistance to help us evaluate proposed manufacturing hours. In estimating this cost element, the contractor used plant-wide labor standards adjusted by a productivity factor resulting from experience on the XYZ contract. The contractor then judgmentally applied a 20 percent complexity factor to reflect the impact of this newly proposed product. We request that an engineer review the reasonableness of the 20 percent complexity adjustment factor.

The contractor also proposed 3 new labor standards, as follows:

- Item 1 -- Set up 1.097; Run 453.301
- Item 2 -- Set up 212.5; Run 63.511
- Item 3 -- Set up 312.4; Run 75.551

We also request the engineer review the reasonableness of these standards.

We would appreciate receiving the engineer's review results by November 15, 20XX.

We will notify your office of any significant issues as they arise during our audit. Our field work is scheduled for completion by November 15, 20XX, with a final report to be issued no later than November 20, 20XX. If you require additional audit services than those cited, please contact Dain Williams, Senior Auditor, or Danica Wells, Supervisory Auditor, at (703) 111-1111 or fax (703) 111-2222. Our e-mail address is dcaa-faoxxxx@dcaa.mil.

LINDA BELL  
Branch Manager

**DCAA Contract Audit Manual**

January 2003

**Figure 4-1-2  
Example Notification Letter**

October 26, 20XX

MEMORANDUM FOR ADMINISTRATIVE CONTRACTING OFFICER  
ADDRESS  
CITY, STATE 12345-6789

SUBJECT: Audit of ABC, Inc.  
Fiscal Year 20XX Incurred Cost Proposal

We are planning to begin the subject audit on November 12, 20XX. The scope of our audit will be based on a detailed risk assessment and auditor judgment. As we discussed last week, your office is concerned about the reasonableness of material requirements charged to government contracts. We will address your concern during the audit. If you have any other input on this audit or concerns which you believe should be addressed by this audit, please discuss them with us at the number listed below.

During the audit, we plan on evaluating the following:

- labor and material cost transfers (the allowability of recorded labor costs were evaluated during the concurrent floor checks performed during FY 20XX)
- material requirements
- indirect expenses with focus on executive compensation, depreciation, public relations and advertising, and employee morale
- interdivisional cost transfers

At this time, we do not foresee a need for technical assistance from your office. However, should a need arise during the audit, we will notify your office and request specific assistance.

We will notify your office of any significant issues that arise during the audit. Our field work is scheduled for completion by December 15, 20XX. We will provide you with a copy of our audit report on or before January 15, 20XX. If you have any questions, please contact Dain Williams, Senior Auditor, Danica Wells, Supervisory Auditor, or myself at (703) 555-1233 or fax at (703) 555-1234. Our e-mail address is dcaafaoxxxx@dcaa.mil.

LINDA BELL  
Branch Manager

January 2003

405  
Figure 4-1-3

**Figure 4-1-3**  
**Example Acknowledgement Letter**  
**Application of Agreed-Upon Procedures**

In reply refer to:

2441-20XXA17900027

March 15, 20XX

MEMORANDUM FOR COMMANDER, DCMA SPRINGFIELD

ATTENTION: Administrative Contracting Officer (T.P. Hunt)

SUBJECT: Acknowledgement of Agreed-Upon Procedures  
New Corporation, Alexandria, VA

REFERENCE: DCMA Springfield Case No. xxx-xx-xxx

We have received your request for DCAA services dated March 12, 20XX to apply agreed-upon procedures to the New Corporation (NC) data submittal titled "Inventory of Government Owned Property, CY 20XX." NC is responsible for the contents of the submitted documentation.

Your office will use our report on application of agreed-upon procedures to update records of accountable government property in the custody of NC and to determine if contractor records are maintained in accordance with the requirements of FAR 45.405, Records and Reports of Government Property. Based on your written request and subsequent discussion with Ms. Jordan of this office, DCMA Springfield retains sole responsibility for the sufficiency of the procedures agreed upon to accomplish this engagement. DCAA is responsible for completing this engagement in accordance with applicable government auditing standards for agreed-upon procedures.

The agreed-upon procedures we will apply in accomplishing this assignment are as follows:

- Select for analysis all line items valued at greater than \$5,000 and a random sample of 40 items less than \$5,000.
- Perform a physical observation at the last recorded location of each selected asset to verify existence. Examine identification markings for conformance with FAR 45.506.
- Select 20 items from the listing of contractual additions placed into service during CY 20XX and verify cost values to the contractor work in process and property ledgers (FAR 45.505-2).

Our report will pertain only to the application of the agreed-upon procedures to the "Inventory of Government Owned Property, CY 20XX". We were not engaged to, and will not, perform an audit, the objective of which would be the expression of an opinion on the subject matter of the report. Accordingly, we will not express such an opinion. Additional procedures, if applied, could bring other matters to our attention that would be reported to you. The report will be prepared using the procedures identified above and any other procedures which may later be agreed upon with you. The information included in our report is intended solely for your use, and should not be used by you or by others for any purpose other than that for which the procedures are established.

We will notify your office of any significant issues as they arise during our evaluation. Our fieldwork is scheduled for completion by April 2, 20XX, with a final report to be issued no later than April 12, 20XX. If you require additional services beyond those cited, please contact Sam Sharp, Senior Auditor, or Isobel Jordan, Supervisory Auditor, at (703) 123-4567 or fax (703) 123-4568. Our e-mail address is dcaa-faoxxxx@dcaa.mil.

James Mack  
Branch Manager

**4-104 Negotiation Memorandum and Findings on Appeals**

a. FAR provides that the contracting officer shall forward to the cognizant DCAA auditor one copy of the Price Negotiation Memorandum (FAR 15.406-3(b)), Memorandum of Disposition of Post-award Audits (FAR 15.407-1(d)), and Final Determinations on Contractor Appeals to DCAA Forms 1. These documents concerning the disposition of audit findings are needed for determining whether revisions in audit techniques and related reporting may be in order, to enable the auditor to be as responsive as possible to the needs of the contracting officer. In addition to serving as a key element in the auditor's continuing self appraisal process, the data are needed for reporting to top management levels in the departments and to the Office of the Secretary of Defense. In order to be timely and fully responsive to the needs of DoD management in providing information on audits, negotiations, etc., all field audit offices will establish formal follow-up procedures to ensure that copies of these contracting officer advices are timely received and promptly reported in the status reports required by Headquarters.

b. If the memorandum provided for by FAR 15.406-3(b) is not received by the auditor within 90 days following issuance of the audit report, and negotiations are known or expected to be completed (for price proposals, questioned costs should exceed \$500,000 to warrant follow-up unless the pricing action has been selected for a defective pricing audit), the field audit office will take follow-up action requesting a copy of the document directly from the cognizant procurement or administration activity with a copy of the request to the full-time onsite PLA or

assigned part-time PLA. If necessary, the field audit office should issue a second follow-up request, identified as such, within 90 days of the first follow-up request for the PNM. Upon receipt of the second follow-up request, the full-time or assigned part-time PLA will become responsible for all further follow-up until the contracting officer distributes the PNM. Where the PLA encounters a continuing problem with timely distribution of PNMs, and corrective action is not effected, the PLA should elevate the matter for resolution by the region with its counterparts in the acquisition or administration activity.

c. Those activities with full time PLAs are listed in 15-3S1. To determine if a part-time PLA has been assigned, contact the regional office responsible for the geographical area where the activity is located.

d. Auditors at subcontractor locations also require similar information relating to prime contractor or higher tier subcontractor negotiations with subcontractors. This information is needed for postaward auditing, assessing performance, and reporting purposes. The auditor at the prime contractor or higher tier subcontractor location should ensure that maximum support is given to subcontract auditor requests. In the event a contractor refuses to release the information for use outside its organization, it will be necessary for the auditor at the prime contractor or higher tier subcontractor sites to review the subcontract file and report pertinent information to the subcontract auditor.

e. Follow-up is required for copies of Final Determination on Contractor Responses to DCAA Forms 1. 6-908c states that the auditor must have received a copy before a resubmission voucher can be processed.

#### **4-200 Section 2 --- Coordination with Contractor Internal and External Auditors**

##### **4-201 Introduction**

This section discusses requirements for maintaining effective relationships with contractor internal and external auditors.

##### **4-202 Relationships with Contractor Internal and External Auditors**

###### **4-202.1 Coordinated Audit Planning**

a. The auditor's evaluation of a contractor's internal controls, pursuant to 5-100, may disclose, particularly at a major defense contractor location, that a contractor maintains a highly professional internal audit staff. In addition, most larger contractors also engage an external public accounting firm to conduct an audit of their financial statements. While these internal and external auditors' final audit objectives are not the same as DCAA's, the means of achieving these differing objectives often overlap. This frequently results in duplicative audit procedures. Whenever there are multiple audit organizations involved, consideration should be given to coordinated audit planning. Such a program must, of course, be predicated upon the contractor's agreement to make available to DCAA relevant internal and/or external audit working papers and reports (see 4-1000). Since the external auditor's working papers do not belong to the contractor, there must be agreement between the contractor and the external auditor to provide access to DCAA. This may be accomplished in the engagement letter. Also, before communicating directly with an external auditor regarding contractor information, a letter should be obtained from the contractor indicating that there are no objections to such communication.

b. Coordinated audit planning is a voluntary process wherein DCAA and the contractor's internal and external auditors consider each other's work in determining the nature, timing, and extent of auditing procedures. Coordinated audit planning considers the extent to which reliance can be placed upon work performed by the other auditor to minimize duplication of audit effort. In addition, this process strengthens the evaluation of internal control systems.

c. The primary benefit of coordinated audit planning is that it promotes contractor self-governance, enabling organizations to better develop and maintain strong systems of internal controls. Coordinated audit planning also helps identify and eliminate duplicative audit effort, thus saving resources for all parties. It is an efficient and effective means for conducting oversight and it provides contractors with better visibility into and understanding of government oversight criteria. This promotes communication, cooperation, and respect among the various auditors.

d. The specifics of a contractor's participation in coordinated audit planning should be discussed at the annual planning meeting between FAO management and contractor executives. If the contractor elects to participate in coordinated audit planning, or if the auditor intends to rely upon any work performed by internal auditors, the FAO should update permanent files annually to document the continued organizational independence of the internal audit department and their objectivity in conducting audits.

e. The coordinated effort may be accomplished either through the adoption of complementary audit programs for separate performance by the respective audit staffs or through joint audits. The sharing of overall annual audit plans or participation in such programs as the Contractor Risk Assessment Guide does not constitute a joint audit. A joint audit is one in which the government and the contractor have mutually assessed risk, developed an audit program, and conducted field work in the audit of a particular area. When audit steps are performed jointly, each audit organization will maintain supervisory responsibility over its respective audit staff.

f. In some instances, for reasons such as limitations imposed on the scope of the contractor's internal audit activities or the sensitivity of the audit area, it may not be feasible or desirable to adopt a joint audit approach. However, even in such instances, the work of the contractor's internal and external auditors should be considered in assessing risk and in establishing audit scope. Areas particularly appropriate for consideration include tests of the overall accuracy of computations, accounting records, compliance with established internal controls and procedures, material and

inventory pricing, payroll preparation, labor distribution, and accounts payable. To reduce the extent of audit work which would otherwise be performed by the DCAA auditor, reliance should be placed on the contractor's internal and external audit activities commensurate with the nature, scope, and effectiveness of work performed. See 4-1000 for documentation requirements when relying upon the work of others.

g. At contractors where internal and/or external working papers and reports are made available to DCAA, the FAO should make arrangement to receive reports impacting DCAA audit work when the audits are completed. The FAO should review the report shortly after receipt to determine if there are any reported items that need follow-up or, affect in process, planned audits, or the annual audit plan. The FAO should also request annually a listing of reports issued and perform a reconciliation to ensure all reports have been received. When a report indicates significant audit deficiencies or major problems with billings to the government, the auditor should conduct a timely fact finding of all issues and communicate the findings to the proper government personnel. All oral communications should be confirmed in writing on a timely basis (see 1-403.3).

#### **4-202.2 Access to DCAA Working Papers**

a. Under a coordinated audit planning program the contractor's internal or external auditors are authorized access to most relevant DCAA working papers. However, contractors' internal and external auditors are not authorized access to the following:

- (1) DCAA Form 2000 and associated working papers.
- (2) Audit reports and associated working papers when reports have a contingent release statement (see 10-212.2). These may be released with permission of the contracting officer.
- (3) Government technical reports and post-negotiation memorandums. These may be released with permission of the originator.
- (4) Reports or information on subcontractors. This information may be released if authorized by the subcontractor.
- (5) Administrative forms or appraisal evaluations.
- (6) Classified working papers.

(7) Working papers discussing unsatisfactory conditions on the part of government personnel (see 4-803.2b).

(8) Sensitive materials related to DoD Hotline issues.

b. DCAA working papers are considered government property and, as such, DCAA must maintain physical custody. To the extent practical, the other auditors should satisfy the evidence requirement by reference to, or notes and extractions from, DCAA working papers. Copies should generally be made only when referencing notes or extraction would not be practical. If copies are required, the other auditor should provide a list to the DCAA auditor who in turn will arrange for reproduction. A list of the documents provided will be retained in the DCAA working papers.

#### **4-202.3 Coordinated Audit Matrix**

At those contractors participating in coordinated audit planning, a coordinated audit matrix should be prepared at the beginning of the year. This matrix should identify the areas of audit coverage for the coming year, the parties responsible for performing the specific audit work, and milestone dates. There should be ongoing status and program evaluation meetings to assess progress on the coordinated audit plan and to discuss audit results.

#### **4-203 DCAA Response to Accounts Receivable Confirmation Requests from CPA Firms**

a. Auditors occasionally receive requests from CPA firms to confirm the amounts represented by their clients as receivables due from the government. These requests normally apply to contracts where provisional approval for interim payment of costs incurred to date is DCAA's responsibility. Confirmation of receivables is a generally accepted auditing procedure whereby the CPA seeks to verify the existence and accuracy of the dollar amounts reported as accounts receivable on the contractor's financial statement. Under government contracting, it may be expected that the CPA will request positive rather than negative confirmation; in either case, it is DCAA policy to acknowledge each request.

b. Contractors usually establish a receivable under cost-reimbursement type contracts, in the amount of a public

voucher, at the time it is submitted to the auditor. However, we cannot reasonably determine the exact timing of contractor payment by the disbursing office or the total amounts unpaid at any prior point in time. Furthermore, public vouchers represent claims for interim payments which are provisional in nature and subject to retroactive adjustments at any time prior to approval and payment by the government of the contractor's completion voucher. Therefore, the auditor is not in a position to issue an unqualified confirmation of accounts receivable amounts, and could not issue a qualified confirmation of outstanding billings without the disbursing office coordination.

c. A confirmation request may also include contract billings which are not subject to audit approval, such as for progress payments, economic price adjustments, or deliveries under fixed-price type contracts. It is not appropriate for DCAA to expend any effort attempting to confirm such billings.

d. Because of the above considerations, auditors will not attempt to confirm amounts claimed by contractors as due from the government. Tactfully and

promptly acknowledge a CPA's confirmation request by letter, with a brief statement as to why we are not in a position to confirm a contractor's accounts receivable. Also provide, if available, the name and address of the government disbursing office where additional information may be pursued if the firm so desires. For example, the acknowledgment might read:

"We acknowledge receipt of your confirmation request dated August 15, 20XX, concerning amounts represented by the XYZ Company as due from the Department of the Army as of July 31, 20XX."

"Until completion of a cost-reimbursement type contract and later final settlement of the costs, we are not in a position to confirm that amounts claimed by a contractor are payable under the contract. Also, under any type of government contract, we cannot determine the unpaid billed amount at any prior point in time because we do not maintain records of payments made. If you wish to pursue confirmation of the outstanding billed amounts, we suggest that you address your inquiry to the Army Finance Office, (address)."



**4-300 Section 3 --- Conferences With the Contractor (Entrance, Interim, and Exit) on Audit Plans and Results****4-301 Introduction**

a. This section provides guidance on audit conferences with the contractor. It states the basic requirements for and the extent and nature of discussions during entrance, interim, and exit conferences in general and under each type of audit assignment.

b. Additional guidance on program plan and risk assessment conferences with the contractor is contained in the DCAA Audit Planning Manual.

c. Regarding contractor conferences in the mobile audit environment, see supplementary guidance as follows: (1) supervisory auditor participation (see 2-302.31), (2) branch manager participation (see 2-302.30).

d. Special guidance on preliminary conferences after a contract termination (before the contractor submits a settlement proposal) is in 12-205.

e. Special guidance on preliminary conferences when performing concurrent incurred cost audits is contained in 6-404.

f. Conduct all discussions with contractors with objectivity and tact in a forthright, professional manner.

**4-302 Contractor Conferences - Entrance****4-302.1 General Procedures for Entrance Conferences**

a. Except as provided in 4-302.4, hold an entrance conference with the contractor's designated representative(s) at the start of each separate audit assignment (or each group of assignments to be covered in a single field visit). Document the date, participants' names and titles, and primary discussion points, including specific identification of requested data to control what was requested and provided during the audit. The significance or sensitivity of the assignment will dictate the level and number of audit personnel who should attend the conference.

b. As a minimum, explain the purpose of the audit, the overall plan for its per-

formance including the estimated duration, and generally the types of books, records, and operations data with which the auditor will be concerned. If applicable, the following matters should be handled during or shortly after the entrance conference:

(1) Make arrangements for any necessary work space and administrative support. Primarily, this applies to mobile assignments; however, auditors in a resident office or suboffice may also need temporary space in a particular operating location to expedite an audit with budgeted hours of a month or more, such as a system audit.

(2) Ask the contractor to designate primary and alternate officials with whom audit matters are to be discussed during the course of the assignment. However, make it clear that such an arrangement does not preclude access to other knowledgeable contractor personnel as needed during the audit. Also make it clear that these arrangements should not cause delays or extra audit work (hence the advisability of having named alternate officials to expedite the audit should the primary official be unavailable). Complex, detailed, and time consuming procedures, such as requiring all data requests be written and/or funneled through a single individual only, are an obstruction to efficient audit operations. Contractor representatives' actions which unreasonably restrain, restrict, or delay the audit should be processed using the denial of access to records procedures set forth in 1-504.3.

(3) Discuss, or obtain a briefing on, the contractor's proposal(s) or other cost representation(s) to clarify any preliminary questions, understand the basis of each submitted cost element, and learn the nature and location of supporting data.

(4) Visit all office and/or plant operating areas used in performing current and proposed contract(s).

(5) Arrange to review the planning documents, working papers, and audit reports of the contractor's internal and external auditors for any audits or reviews performed or planned that may curtail the planned scope of work. See 4-202 for

guidance on coordinated efforts with the contractor's auditors.

(6) Arrange for any needed IT audit assistance (see 4-500).

(7) When the assignment involves a subcontractor's cost representation(s), resolve any restrictions on release of audit findings and report information to higher-tier contractor(s) per 9-106.4.

(8) Do not enter into written agreements with contractors, or affix concurrence signatures to contractor letters, which contain procedural arrangements that inhibit and/or delay the audit performance or restrict the reproduction of necessary supporting evidential matter.

#### **4-302.2 Special Considerations for Entrance Conferences on Major Operations Audits**

a. Hold a planning meeting with the contract administration office technical specialist(s) in advance of the joint entrance conference with the contractor, whenever technical assistance is being provided or a joint review/audit is being conducted. The technical specialist(s) should help develop the entrance conference agenda, such as identifying necessary data to be requested from the contractor. Also invite the specialist(s) to participate actively in the conference itself.

b. Notify the contractor's management several weeks before starting an operations audit or other system audit. This notice may be oral or in writing depending on resident working arrangements (4-302.4).

c. As applicable, mention the following matters during the initial contact before the entrance conference, and follow up during the entrance conference on each major system in addition to those matters common to all assignments (4-302.1).

(1) Request the cooperation of the contractor's top management and operating area management to expedite the audit.

(2) Give the contractor's management personnel an opportunity to explain how they have discharged their responsibilities to establish and maintain adequate internal accounting and administrative controls in the area being audited.

(3) Request the contractor to identify all reports and analyses used by any management level to evaluate and control the effectiveness, economy, and efficiency of the audit area.

(4) Request the contractor to provide an informational briefing on the organization and operations involved in the area to reduce the audit time. Such briefings may cover: organizational assignments affecting the area; system descriptions and/or flowcharts of transaction flows and system controls; and any identified problems and planned corrective actions or other planned changes in the area.

(5) Invite the contractor to participate actively in the evaluation.

(6) Explain in advance the DCAA procedures for submitting draft statements of conditions and recommendations, and establish time frames for the contractor's written responses (see 4-304.5b).

#### **4-302.3 Confirming Letter on Certain Major Assignments**

Issue a letter to the contractor on major system audits confirming the arrangements made and significant matters discussed at the entrance conference. Keep the letter's tone courteous and express appreciation for the arrangements made. At the FAO's discretion, use a similar letter for other major audit assignments to help maintain good working relations with the contractor. However, make it clear that the arrangements should not in any way restrict access to records or personnel necessary to the audit performance. Predeterminations of all records, facilities, contractor personnel, etc. that may be needed before starting an audit are not possible.

#### **4-302.4 Resident Working Arrangements for Entrance Conferences**

a. Where auditors are assigned full time at the contractor site, it is usually desirable to establish local working arrangements for entrance conferences with the contractor. For example, some contractors may require that the auditor contact certain key personnel before starting specific types of audits (see 4-302.1b.(2)). The contractor may

designate a permanent government liaison representative for audits of a general nature, or the contractor's controller as the contact point for any financial system or compliance type audit and the chief of estimating as the principal contact for price proposal audits. A contractor might also desire a formal entrance conference only on major or nonrecurring audits while price proposal audits or other recurring audits are handled in a prearranged manner.

b. Working arrangements should be established only upon full mutual concurrence of the contractor and the FAO manager. They should not be permitted to restrict access to records or otherwise limit the audit scope. They should expedite the audit and not become so cumbersome as to cause delays or extra work.

c. Do not sign agreements for local working arrangements. If documentation is necessary, a confirming letter may be issued by the contractor, subject to cancellation or revision at any time upon the auditor's request. Make it clear that the auditor will bypass the arrangements anytime that they impede the audit. Additionally, do not enter into written agreements or affix concurrence signatures to contractor letters containing any access to records provisions. Understandings with contractors on reasonable conditions and procedures for the conduct of an audit shall not prejudice DCAA's access rights to perform audits and shall not be formalized in written agreements signed by DCAA representatives.

d. As a minimum, the resident auditor or resident AIC will hold periodic conferences, usually more than one a year, with the contractor's designated representative at the controller or higher level position. At such conferences, discuss any audit matters that need special management attention and advise the contractor of any changes in audit plans by major audit segment. Document such discussions.

#### **4-303 Contractor Conferences - Interim**

##### **4-303.1 General Procedures for Interim Conferences**

a. Throughout each audit assignment, discuss matters with the contractor as necessary to obtain a full understanding of the

basis for each item in the contractor's pricing data or other cost representation, or each aspect of the area being audited. Disclose to the contractor any factual duplications, omissions, or other mistakes noted in the contractor's submission, records, or supporting data. As the audit progresses, conduct further discussions as needed to gain assurance that audit conclusions will be based on a complete understanding of all pertinent facts. Document all discussions in the working papers, including date, participants' names and titles, and primary discussion points. If warranted, the discussions should be confirmed in writing to the contractor, and if necessary, a copy should be sent to the ACO.

b. In the interest of equitable dealings with the contractor and in the proper discharge of official duties, apprise the contractor of any significant understatements noted in price proposals, reimbursement vouchers, or other cost representations when such understatements are clearly the result of obvious and unintentional oversight, bookkeeping or arithmetic errors, etc. Such cases may include mathematical errors in using improvement curve and other computational analysis techniques.

c. If apparent understatements of estimated costs in price proposals or related submissions do not meet the criteria stated above, do not discuss the auditor's conclusions with the contractor unless the negotiating contracting officer so requests. (See 4-304.2.)

d. Handle errors on reimbursement vouchers as set forth in 6-1008e.

e. Communicate major audit problems encountered to contractor officials authorized to make a decision. The notification should be made at the earliest possible time, with written confirmation to the contractor of any oral discussions, and if necessary a copy to the ACO. Do not wait until the final exit conference or the issuance of the audit report. Document any oral discussions with appropriate memorandums or notations in the working papers. Major audit problems include:

(1) Denial of access to records, including but not limited to:

(a) Unavailability of contractor personnel,

(b) Failure of contractor personnel to complete audit schedules on a timely basis,

(c) Unreasonable delays by management in permitting the commencement of the audit or in providing needed information.

Follow procedures in 1-504.3 when denial of access is encountered.

(2) Items that impact the reliability of the contractor's books and records, including major internal control weaknesses,

(3) Significant differences concerning the application of generally accepted accounting principles,

(4) Conclusions regarding the reasonableness of estimates used in developing forward pricing/bidding rates,

(5) Any other items that may affect audit performance.

#### **4-303.2 Incurred Cost Submissions**

Promptly discuss significant system deficiencies found during performance of incurred cost audits with the contractor. Equally important is the timely written notification to the ACO of these deficiencies. Significant deficiencies are those with significant dollar impact on existing or future contracts or which require that the contractor take corrective action(s). Normally discuss the deficiencies during each system (material, labor, indirect expenses, etc.) audit. Oral discussions with the contractor should be followed up in writing to prevent any misunderstanding of the deficiencies found, and to solicit the contractor's plan of corrective action.

#### **4-303.3 Operations Audits – Interim Conferences**

a. During the audit, keep the contractor's designated representative informed of any problems encountered and interim results of completed phases. If necessary for the efficiency of the audit, a written follow up of the discussions should be sent to the contractor as soon as possible.

b. If contract administration personnel are assisting or participating in the audit, fully coordinate interim findings and recommendations with them before discussing deficiencies with the contractor. DFARS

Subpart 242.70 joint reviews especially require close coordination to assure team members' consensus and complete understanding of the findings by the contract administration office. Also coordinate with contract administration technical personnel when the findings involve their area of expertise, but their assistance could not be provided during the audit. Discussions with the technical personnel in such cases can help clarify and/or support the findings when presented to the contractor.

#### **4-304 Contractor Conferences -- Exit**

##### **4-304.1 General Procedures for Exit Conferences**

a. Upon completion of the field work on each separate assignment or field visit, hold an exit conference with the contractor's designated representative and summarize the audit results as provided in succeeding paragraphs. Even when there are no questioned or unsupported costs, noncompliances, system deficiencies, or cost avoidance to be reported, the exit conference is a minimum courtesy to the contractor and is an important part of sound contractor relations. Exceptions may arise when the audit is performed in support of litigation (4-304.7), investigations (4-702.5), or voluntary disclosure verifications (4-707.3).

b. Confirm or follow up on requests for the contractor's reaction to any audit exceptions on incurred costs (4-304.4), operations audits (4-304.5), and CAS adequacy and compliance audits (4-304.6) for inclusion in the audit report.

c. If applicable (especially on mobile audits), inform the contractor that the audit findings, conclusions, and recommendations are subject to normal DCAA review by the auditor's office before the audit report is issued, and that the contractor will be advised if any significant changes are made.

d. Document the exit conference in the working papers, including date, participants' names and titles, and specifically discussed items and associated contractor's reaction, if any. This provides the information to be included in the audit report, required by 10-210.5d.(1).

**4-304.2 Price Proposals**

a. This category includes contractor proposals to establish:

(1) initial prices under all types of negotiated contracts;

(2) successive target prices and interim prospective prices under FPR- and FPI-type contracts;

(3) price changes for contract change orders;

(4) other contract price adjustments and Contract Disputes Act (CDA) claims including those for alleged delay and disruption and requests for extraordinary contractual relief;

(5) forward pricing rate agreements; and

(6) special or flexible progress payment rates.

Treat the incurred cost portion of final FPR/FPI price redetermination proposals, equitable adjustment proposals and CDA claims as an incurred cost submission (4-304.4) and the projected portion under this paragraph.

b. Discuss any factual differences found during the audit with the contractor and obtain a reaction for further analysis or inclusion in the audit report. However, pursuant to FAR 15.404-2(c)(1)(i), do not disclose to the contractor the audit conclusions and recommendations on projected costs or rates that are subject to contracting officer negotiation, except as specifically requested by the negotiating contracting officer. (Discussion of actual cost submissions, even if subject to negotiation, is covered in 4-304.4.) As an example, a labor cost estimate proposed by the contractor may reflect a learning or improvement trend different from the contractor's prior cost experience, with no apparent justification. In this example, you would discuss with the contractor the factual aspects of the prior cost experience and inquire why the experienced trend was not considered appropriate to project future costs. You would not, however, discuss your audit conclusions or disclose the amount of proposed labor costs to be questioned, if any, in the audit report.

c. Discuss with the contractor any discrepancies noted in the cost or pricing data, as defined in FAR 2.101, whether they in-

crease or decrease the contract price. As part of these discussions, inform the contractor of any cost or pricing data found to be inaccurate, incomplete, or noncurrent. Confine the discussions to factual aspects of the data, and do not attempt to influence the contractor to change the proposal. Any changes in the proposal should be based on the contractor's own initiative by formal written submission to the contracting officer.

d. Advise the contractor of any costs to be reported as unsupported (see 10-304.8c).

e. Discuss with the contractor any other CAS and FAR noncompliances found during the audit and, as appropriate, provide details for the contractor's analysis and reaction.

**4-304.3 Postaward Audits of Cost or Pricing Data for Possible Defective Pricing**

a. Discuss any factual indication that cost or pricing data may have been defective to afford the contractor an opportunity (normally 30 days) to review the matter and provide any additional information for the auditor's consideration. A draft copy of the report exhibit(s) and accompanying footnotes normally should be provided to the contractor. Final determination as to the existence and extent of defective pricing remains the responsibility of the contracting officer.

b. The contracting officer should also be provided the draft report exhibit(s) and accompanying footnotes on apparent defective pricing issues and given the opportunity to provide comments. See 14-122 regarding discussions of the audit findings with the contracting officer. The auditor should discuss the findings throughout the course of the audit rather than only at the end.

c. The contractor may contend that there were understated estimates offsetting any potential price reduction that would result from a contracting officer's defective pricing determination. For contracts entered into on or before February 15, 1987, request specific supporting data for audit evaluation and inclusion in the audit report. For contracts entered into after February 15, 1987, request the contractor provide

appropriate certification and specific data supporting the offsets for audit evaluation and inclusion in the audit report (see 14-118 and 10-606.5d).

d. Although the auditor should not expend resources examining uncertified contractor offsets, the auditor should objectively disclose all of the facts known. Therefore, apparent offsets discovered during the postaward audit should be disclosed to the contractor for its analysis and offset submission if the contractor deems appropriate. (Refer to 14-118 for treatment of offsets in the audit position on recommended price adjustments).

e. Coordination and discussion of the findings by all parties before the audit report is issued can minimize delays in the resolution process. Postaward audit reports should not be issued until the initial findings have been properly coordinated.

#### 4-304.4 Incurred Cost Submissions

a. This category includes cost reimbursement vouchers and contractor representations of incurred costs to establish:

- (1) final prices on all types of completed negotiated contracts,
- (2) final indirect cost rates,
- (3) contract termination settlements, and
- (4) equitable adjustment proposals and CDA claims.

Contractor requests for progress payments authorized by the contract will be treated under this paragraph even though projected costs are involved in the calculations. Proposals to establish special or flexible progress payment rates and interim changes in contract prices are covered in 4-304.2.

b. Discuss all audit conclusions with the contractor's designated official and try to reach agreement on any questions of conformity with generally accepted accounting principles, applicable cost accounting standards, and other cost principles incorporated in the contract(s). If there are audit exceptions to be reported, request the contractor's official reaction for inclusion in the audit report or in the notice of costs suspended or disapproved.

c. See 6-902c and d for special discussion procedures on costs to be suspended

or disapproved under cost-reimbursement-type contracts.

d. As discussed in 6-902e, the auditor should notify the ACO of developing issues which may result in the issuance of a DCAA Form 1 as follows:

(1) Provide the ACO with written documentation of the audit results which were discussed with the contractor at the exit conference, unless the contractor immediately agreed to all audit exceptions and the written report will be issued within the next 30 days. The written documentation may be in the form of a memorandum to the ACO, a copy of a memorandum for the file setting forth the results of the exit conference, copies of a draft report exhibit and/or notes, or copies of working paper exhibits and/or supporting working papers. In other words, provide the ACO with whatever information or subset thereof that was provided to the contractor at the exit conference.

(2) Provide the ACO a copy of the contractor's written rebuttal to the audit findings immediately upon receipt.

(3) Discuss significant unresolved issues with the ACO at any mutually agreeable time. Such discussions may result in the introduction of additional data or information which could support or modify audit findings.

(4) The ACO should not ordinarily participate in the formal exit conference. However, if the auditor wishes (or the ACO so requests), the auditor may have the ACO attend discussions with the contractor subsequent to the formal exit conference, if, in the auditor's opinion, this would facilitate the resolution of contested issues. In arriving at this decision, consider factors such as the likelihood of issuing DCAA Forms 1, ongoing relationships with the ACO, and duplication of effort which may result if joint discussions are not conducted.

#### 4-304.5 Operations Audits – Exit Conferences

a. This paragraph covers evaluations of contractor's operations for economy and efficiency and financial compliance, including audits of internal controls, major system

surveys, and joint reviews under DFARS Subpart 242.70.

b. After full discussion of each matter requiring contractor action, provide the contractor a draft statement of the condition(s) and recommendations. Carefully design the discussions and drafts to elicit contractor concurrence with recommended system improvements and/or cost avoidance. Request an official written response for inclusion in the audit report, and establish a time frame for the contractor's response. Allow ample time for the contractor to consider the audit presentations, and be receptive to alternatives the contractor may suggest that will satisfy the audit objectives.

c. If the contractor does not agree with the audit recommendations and provides a response, the auditor should provide in the report comments specifically on the contractor's response. If specialist or technical assistance is required in evaluating those alternatives, the auditor should obtain the assistance. Do not merely restate or amplify a position already stated.

d. If the evaluation results in cost avoidance recommendations, make the contractor aware that, effective immediately, any impact of such recommendations will be reflected as questioned costs in reports on price proposal evaluations when applicable (in accordance with the criteria in 9-308).

e. See further guidance on discussion of audit findings as part of a team review in 5-1302 (contractor's purchasing system review team), 5-1303 (contractor's insurance/pension review team), and 5-1200 (surveys of contractor estimating systems).

#### **4-304.6 Cost Accounting Standards Audits**

a. This paragraph covers CAS disclosure statement adequacy audits, compliance audits (including audit reports on CAS noncompliance), and cost impact proposal audits.

b. Discuss the results of adequacy audits with the contractor. If one or more disclosures are considered inadequate, provide the contractor a draft copy of the audit report for its comments. The letter

transmitting the draft audit report should solicit the contractor's specific comments on the adequacy issues and advise that the comments will be included in the audit report if received by a specified date. Provide the contractor a reasonable period of time to respond to the draft audit report. Do not delay issuing the report, however, if the comments are not provided in sufficient time to permit their inclusion by the established report due date.

c. Thoroughly discuss apparent CAS noncompliances with the contractor to establish that the audit findings are based on a proper understanding of the issues and that all pertinent facts have been considered. Do not state that the auditor is making a determination of noncompliance, since the contracting officer makes this determination. Provide the contractor a draft copy of the audit report for its comments. The letter transmitting the draft audit report should solicit the contractor's specific comments on the compliance issues and advise that the comments will be included in the audit report if received by a specified date.

d. Discuss the results of cost impact proposal audits with the contractor to establish that the audit findings are based on a proper understanding of the issues and that all pertinent facts have been considered. Provide the contractor a draft copy of the audit report for its comments. The letter transmitting the draft audit report should solicit the contractor's specific comments on the audit exceptions and advise that the comments will be included in the audit report if received by a specified date.

#### **4-304.7 Litigation Support**

a. Audit work is privileged when performed at the request of government litigation counsel in support of ongoing or anticipated litigation (see 15-503). If there is reason to believe that the audit has been requested in support of litigation, the auditor should ask the requestor to state whether the audit will be covered by the attorney work product privilege. If so, an exit conference could compromise the privilege. When audit work is covered by the attorney work product privilege, the auditor should explain the

importance of the exit conference in resolving audit issues and avoiding errors, and attempt to obtain permission to hold an exit conference. However, to prevent inadvertent compromise of the attorney work product privilege, an exit conference must not be held without litigation counsel's written

consent and coordination on the matters to be discussed.

b. Litigation support should not be confused with investigation support (see 4-702.6). In litigation support, audit access arises from contractual requirements.



**4-400 Section 4 --- Audit Working Papers****4-401 Introduction**

This section contains general guidance for the preparation, format, contents, and filing of audit working papers, whether prepared manually or using computers. The use of documents in electronic format introduces additional complexities to the preparation, format, content, and filing of audit working papers. It is important to follow consistent guidelines and standards for electronic working papers. Major areas that require special attention in an electronic working paper environment are included throughout this section.

**4-402 General**

a. Audit working papers contain information from accounting and statistical records, personal observations, the results of interviews and inquiries, and other available sources. Audit working papers may also include contract briefs, copies of correspondence, excerpts from corporate minutes, organization charts, copies of written policies and procedures, and other substantiating documentation. The extent and arrangement of working paper files will depend to a large measure on the nature of the audit assignment. For example, an audit of a small terminated contract may result in few working papers; an audit at a major contractor where a resident audit office is maintained may generate a voluminous working papers file.

b. The preparation of working papers assists the auditor in accomplishing the objectives of an audit assignment. Working papers serve as the basis for the conclusions in the audit report; provide a record of the work done for use as substantiating data in negotiations, appeals, and litigations; provide guidance for subsequent examinations; and serve as a basis for the audit and evaluation of the work performed.

c. Audit working papers should be prepared at the time audit work is performed and maintained on a current basis. Working papers should reflect the progress of the audit, ensure continuity of audit effort, and permit reassignment of auditors without significant loss of time.

d. Working papers should be relevant to the audit assignment. Files should not include extraneous pages. Superseded working papers should be clearly marked as such and retained.

e. The nature of working papers requires that proper control and adequate safeguards be maintained at all times. Working papers frequently reflect information considered confidential by the contractor, marked "For Official Use Only," or classified for government security purposes.

**4-403 Format and Contents of Working Papers**

a. Standardization in design, content, and arrangement of working papers is desirable because it facilitates the audit, the supervisory auditor's review, and report preparation. This section provides guidance on the Agency's standard working paper format.

b. Conditions and circumstances vary with each audit. It is not practicable to provide uniform instructions as to the material to include in the working papers. This requires the exercise of professional judgment. A constant awareness of the purpose and use to be made of working papers is helpful in determining their content. See guidance in 4-409 and 10-214.1d on revisions to audit working papers after the audit report is issued.

c. Working papers can consist of electronic files such as spreadsheets, word-processing files, graphical images, etc., as well as hardcopy documents when electronic files are not practical. Auditors should strive to use electronic working papers, to the extent possible, to capture the efficiencies provided by information technology, such as storage, search functions, accuracy and processing speed.

d. Two types of working papers are generated during the audit -- audit working papers and administrative working papers. Audit working papers are generated during the field work portion of the audit to document the significant conclusions and judgments of the auditor. They should contain descriptions of the transactions and records examined and the objectives, scope

and methodology (audit procedures) used to develop the conclusions. They should also contain evidence of supervisory review of the work performed. Figure 4-4-1 contains an outline of the Agency's standard working paper format and the indexing protocol for audit working papers. Each audit working paper package will include an index of Audit Working Papers.

e. Administrative working papers are those that do not document field work and audit procedures. They contain elements that result from or lead to field work activities, such as notes/correspondence with government representatives and the contractor. The administrative working papers also contain information and documentation that is used internally by the Agency, such as DMIS data entries (including computations of dollars audited and cost savings), and information to update the permanent files. Although the audit report is not a working paper, it is also filed with the administrative working papers. Figure 4-4-2 contains an outline of the Agency standard administrative working papers. Each audit working paper package will include an index of the Administrative Working Papers.

f. The following is a description of the major audit working paper sections:

(1) W/P A -- Summary working paper contains:

- The summary of audit results, the executive summary and the subject of audit to be forwarded into the draft audit report (see Chapter 10)
- The customer's special requests and requirements
- The audit criteria (e.g., FAR, DFARS, CAS)
- Initial supervisory guidance and audit objectives
- Concluding audit steps
- Interim/final supervisory guidance and review

(2) W/P B -- Risk assessment and preliminary review working paper contains:

- A summary of the risk assessment and the impact the risk assessment has on the substantive testing required to accomplish the audit objectives
- The audit report note on the assessment of control risk (see 5-110)

- Documentation on the examination of internal controls (Internal Control Audit Planning Summaries (ICAPS) or the Internal Control Questionnaire (ICQ), as appropriate) and the impact of this assessment on the audit
  - Documentation on the evaluation of materiality and sensitivity factors, and the impact of this evaluation on the audit
  - Documentation on the evaluation of inherent and other risk factors (e.g., permanent files, prior findings, contract mix, government participation, audit lead sheets), and the impact of this evaluation on the audit
  - Accomplishment of other preliminary audit steps that do not relate to auditing a specific cost element/area
  - Assessment of need for technical assistance and/or assist audit(s) and the related request(s)
- (3) Lead working papers contain:
- The lead schedule for each cost element/area being evaluated (e.g., schedule of proposed and questioned amounts, schedule of control objectives audited and the results)
  - The structured audit report note (see 10-210.6) that describes the work performed for inclusion in the audit report for the cost element/area being audited. The structured note format should be used even if the cost element/audit area will be excluded from the audit report. The structured note will address the following topics:
    - (a) Summary of Conclusions
    - (b) Basis of Contractor's Costs
    - (c) Audit Evaluation
    - (d) Contractor's Reaction
    - (e) Auditor's Response

For internal control examinations and operations audits refer to 10-409, Statement of Condition and Recommendations.

- The tailored audit steps for the evaluation of that cost element/area
- (4) Detailed working papers contain:
- The supporting data, information, schedules and computations for the audit steps on the applicable lead working paper
  - The on-page notes that document accomplishing the tailored audit steps,

support the significant audit judgments and conclusions, and describe the transactions and records examined. These notes will address the following questions:

Who -- who provided the information?

Where -- where is the information (e.g., contractor's office, or FAO permanent file)?

When -- when was the information provided?

What -- what audit tests were performed and what were the results of those tests?

g. It is Agency policy to prepare working papers in electronic format to the maximum extent possible. Working paper templates and audit report shells are incorporated into the Agency's electronic working paper application for most of the audits the Agency typically performs. The generic selection "Other" under the "Miscellaneous Audit Activities Code" may be used for audit areas that lack a specific template or shell.

#### h. Naming Conventions:

(1) To simplify the indexing process in an electronic environment, DCAA has adopted a standardized file naming convention. This convention also establishes standardized procedures for storing in-process electronic working papers, as follows (see 4-407e. for naming conventions related to closing actions):

- Each auditor should have a folder named "Audit Working Papers" on the hard drive of his or her primary computer.
- For each assigned audit, the auditor should establish a new folder within the Audit Working Papers folder. This new folder is assignment specific and should be given the actual assignment name, such as: 2441-20XXB21000001. A four-digit "year" field is used to ensure Y2K compliance.
- All in-process electronic working papers will be stored within the appropriate electronic assignment folder. This methodology will greatly simplify locating audit working papers. In addition, DCAA electronic working

paper software will support this naming and storing convention.

(2) Auditors should name each file beginning with the actual working paper reference, such as A-1, B-2a, T-4, etc. This will be followed with a brief description or actual title of the working paper, such as Evaluation of Engineering Labor Rates or Determination of Current Labor Rates. The combined result will make the identification of electronic working papers much clearer. An example of the file naming convention is shown below:

W/P	Appropriate File Name
A	A -- Audit Summary XYZ Proposal.doc
D-2	D-2 -- Detailed Evaluation of Labor Rates.doc
D-2a	D-2a -- Determination of Current Labor Rates.xls

DCAA electronic working paper software will support this working paper naming feature. In the current Windows environment, users are no longer limited to eight characters with a three-character extension. To make it easier to find documents, auditors should make use of the longer, more descriptive file names. The complete path to the file, including the drive letter, server name, folder path, and file name, can contain up to 255 characters. Not all applications are capable of using the entire 255 characters; for example, some CD-ROM writers are limited to 64 characters. Generally, when an application is not capable of using the 255 characters the software will self-modify the file name.

i. Working papers should contain the following information:

(1) Heading. Head each working paper with the name of the contractor, the assignment number and a title or description. The title or description should convey the purpose of the working papers. Working papers generated using the Agency electronic working paper application will collect and automatically generate the appropriate headings based on user supplied input.

(2) Auditor's and Supervisor's Initials and Date. The requirement for the auditor's

and supervisor's initials and dating applies to both hardcopy documents and working papers that exist only as an electronic file. The work of all auditors contributing to the working paper content, including that of technical specialists, should be identified to the individual work product. The auditor who prepares or completes a working paper should place his or her initials and the month, day, and year the work was performed or completed on each sheet. If the auditor verifies a multiple-page, contractor-prepared document (e.g., bill of material), the auditor should place his or her initials and the date on only the first page of such document. The auditor normally identifies his/her work by initialing in the lower right corner of the audit working paper. When preparing or completing electronic working papers, the auditor's initials will be typed in by the auditor using the Bold Italic font, which will set the auditor's initials out from the text of the working papers.

An acceptable example:

***W.H.R.***  
***12/16/98***

Color fonts may also be used to further distinguish initials and dates; however, care should be taken in selecting colors that are easy to read even when printed on a non-color printer. It is not necessary for supervisors to indicate their review and approval on each working paper. Supervisory guidance, review, and approval must be evident in the working papers, however. As a minimum, to indicate final review and approval of the work, supervisors should initial and date the lead working papers, the top page of the summary working paper section, the top page of the risk assessment/preliminary review section and the top page of the draft audit report. As with the auditor's initials, the supervisor's initials on electronic working papers should be in a font style that sets it apart from the text of the working papers. For supervisory review, also use the Bold Italic font to easily distinguish the supervisor's initials from the audit working paper text. The Agency's electronic working paper application is structured to provide space for auditor initials and date in the lower right corner of audit working papers as appropriate. Spacing is also provided for supervisory approvals. Initialing these documents is evidence that the working papers have been

reviewed to the extent necessary for the supervisor to ensure the audit objectives have been accomplished and there is adequate evidential matter to support the audit findings.

(3) References. The working paper reference scheme should follow a "top-down" approach. Avoid referring from lower level working papers (i.e., detailed working papers) to higher level working papers (i.e., lead and summary working papers). As a minimum, reference the following:

- The summary results and notes in the draft audit report to the summary and lead working papers.
- Information in the summary working papers to the related lead working papers.
- Risk assessment/preliminary review working papers to the related detailed working papers.
- The lead working papers to the detailed working papers.
- The detailed working papers to the next lower level of supporting working papers.

Audit working papers may follow the top-down approach using any one of the following examples:

- See W/P K-2a
- Source W/P K-2a
- W/P K-2a

All are acceptable, provided they clearly direct the auditor to the appropriate source working paper. It may be preferable to provide a more detailed reference such as: "See W/P -L-1, line 45, column B." The level of reference detail is subject to individual auditor judgment and to any supervisory or FAO specific preferences.

Electronic working papers can add increased complexity to the referencing process. The easy integration of Windows based software packages allows for electronic references to source data. Specifically, such functions as Hyperlinks, Copy and Paste, Linked Objects, Embedded Objects, etc., increase the auditor's ability to manipulate data within and between working papers. Auditors are encouraged to make use of this technology; however, it is essential to maintain the requirement to specifically annotate the appropriate working paper reference.

j. Stated References. Electronic working papers and the draft audit report must include a stated reference. A stated reference is an actual working paper reference such as A-1, B-2a, T-4, etc. Maintaining a stated reference within the electronic working paper is also a sound business practice. It may be needed if the working paper is printed at a later date, or if the electronic links are severed. Similar to the designation of auditor and supervisory initials, working paper references should be distinguished using the Bold Italic font. Color fonts may also be used to further distinguish working paper references; however, care should be taken in selecting colors that are easy to read when printed.

k. Indexing.

(1) Index each working paper as it is prepared. The Agency standard indexing protocol is described in Figure 4-4-1. In practice, auditor working paper packages can consist entirely of electronic files or include a mix of electronic files and hard-copy working papers. Each audit working

paper package, whether in electronic or hardcopy form, will follow the standard indexing structure.

(2) Every audit working paper package that includes electronic files must contain a listing of all electronic files. This listing should be considered part of the Administrative or Audit Working Paper index. The listing of electronic files should be sorted by working paper section. If the assigned file name does not adequately describe the electronic file, additional narrative should be provided. Figure 4-4-3 contains an outline of an index to Audit Working Papers Electronic Files.

1. When the audit report has been electronically transmitted to the customer, the exact same file transmitted must be included in the working paper package (see 4-407e.(2)). An electronic copy of the draft audit report, cross-referenced to the working papers, and an electronic version of the acknowledgment letter must be retained in the audit working paper package.

**Figure 4-4-1  
Standard Working Paper Format and Indexing**

Summary Working Paper	A(1 / ), A(2 / ), etc.
Includes:	
Audit Summary	
Executive Summary	
Results of Audit	
Within Summary Working Paper the following working papers are required:	
Planning Document	A-1(1 / ), A-1(2 / ), etc.
Planning Document includes:	
Subject of Audit	
Initial Supervisory Guidance/Audit Objectives	
Concluding Audit Steps	
Interim Guidance/Corrective Actions	A-2(1 / ), A-2(2 / ), etc.
Final Review Comments	A-3(1 / ), A-3(2 / ), etc.
Risk Assessment/Preliminary Review Working Paper	B(1 / ), B(2 / ), etc.
Includes the Summary of Risk Assessment	
Within Risk Assessment Working Paper the following working papers are required:	
Audit Planning Considerations/Preliminary Audit Steps	B-1(1 / ), B-1(2 / ), etc.
Documentation of Risk and Assessment of Internal Controls	B-2(1 / ), B-2(2 / ), etc.
Assessment of Need for Technical Assistance/Assist Audit	B-3
Lead Working Papers	C(1 / ), D(1 / ), etc.
Include the Tailored Audit Steps for the Cost Element/Area Being Audited	C-1(1 / ), D-1(1 / ), etc.
Detailed Working Papers	C-2(1 / ), D-2(1 / ), etc.
Supporting Working Papers	C-2a(1 / ), D-2a(1 / ), etc.

**Figure 4-4-2**  
**Administrative Working Papers**

Following are the contents of the Agency administrative working papers section and their sequence:

1	<u>AUDIT REPORT</u>
1.a.	Cumulative Allowable Cost Worksheet (CACWS)
2	Computation of Dollars Audited & Cost Savings
3	Defective Pricing Lead Sheets
4	Negotiation Data / Disposition of Audit Results
5	Audit Leads (check if positive)
	<u>CORRESPONDENCE</u>
6	Entrance / Exit Conference Notes
7	Government Notes / Correspondence
8	Contractor Notes / Correspondence
9	Technical Report
10	Assist Audit Reports
11	Acknowledgment / Notification Letter (Original / Revised)
12	Request For Audit (Original / Revised)
	<u>PERMANENT FILE UPDATE WORKING PAPERS</u>
13	ICAPS/ICQs Sections
14	Contract Briefs
	<u>AGENCY ADMINISTRATIVE WORKING PAPERS</u>
15	DMIS
16	Tick Marks Legend
	<u>FAO SPECIFIC WORKING PAPERS</u>
17	_____
18	_____
19	_____
20	_____
21	
	<u>CONTRACTOR'S SUBMISSION, DATA, ETC.</u>
22	Contractor's Submission, Data
23	Revised Contract Submission/Data

Figure 4-4-3

**Figure 4-4-3**  
**Supplemental Index to Audit Working Papers**  
**Electronic Files**

Working Paper	File Name	Description
A	A- Audit Summary XYZ Proposal.doc	
A-1	A-1 Planning Document – XZY proposal.doc	
D	D- Summary of Labor Rates Evaluation.doc	
D-1	D-1 Audit Program for Audit of Labor Rates.doc	
D-2	D-2 Detailed Evaluation of Labor Rates.doc	
D-2a	D-2a Determination of Current Labor Rates.xls	
D-2b	D-2b 53120XX class E-Payroll.dat	Extract from May 20XX Total payroll - 5398x.txt

#### 4-404 Working Papers - Agenda Sheet

In the course of the assignment, matters may arise which are not settled immediately either because the information is not available or the auditor wishes to avoid interrupting the work at hand. Develop a separate agenda sheet or "To Do" sheet listing matters for further examination as the audit proceeds. Before completion of the audit, resolve each item on the agenda sheet. Items which may be placed on the agenda sheet include:

- a. Differences to be investigated.
- b. Items to be discussed with contractor personnel.
- c. Additional audit steps to be performed after preparation of an analysis or schedule.
- d. Unavailable contractor records to be examined later.
- e. Follow-up on partially completed transactions.
- f. Items requiring discussion with or approval of the contracting officer or technical or supervisory personnel.

#### 4-405 Working Papers Files

Working papers are generally classified into two categories: the permanent file and the current file. General guidance as to the contents of each and their interrelationship is presented below.

##### 4-405.1 Permanent File

- a. The permanent file on each contractor is a central repository of information

gathered during the course of an audit which has continuing value and use to subsequent audits expected to be performed at the same contractor. Permanent files are useful in preparing the audit program and in determining the appropriate scope of subsequent audits. They also provide ready means for auditors to become familiar with the contractor's operations and any existing audit problems or contractor system weaknesses. While summary information on the contractor's organization, financial structure and policies and procedures may sometimes be included in permanent files for smaller contractors, such information on large contractors with continuing audit activity is generally maintained in the field audit office at a central reference library.

- b. The third mandatory annual audit requirement (MAAR) is to maintain and update permanent files for new or changed contractor organizations, operations, policies, procedures, internal controls, and accounting methods that influence the nature, level, and accounting treatment of costs being charged or to be charged to government contracts. The purpose of this mandatory annual audit requirement is to ensure that any of the above type information gleaned from current audit work is summarized or referenced where it is likely to have a continuing value to subsequent audit work. It is not necessary to establish separate audit assignments to gather organizational or procedural manual changes and to file such information in the permanent files when it has no immediate or obvious in-



fluence on future audit assignments. In making this distinction between what is needed and all other information, the auditor must be alert and exercise proper judgment. Additional guidance for both major and nonmajor contractors is in the DCAA Audit Planning Manual.

c. Following is a list of items which would logically be included in the permanent file as having continuing value in future audit assignments:

- (1) Internal control assessment planning summary sheets.
- (2) Internal control questionnaires.
- (3) MAARs control log.
- (4) Disclosure statement and revisions in accordance with CAS rules and regulations.
- (5) CAS compliance control schedules and a noncompliance summary schedule (through FY 1991).
- (6) DMIS CAS Compliance Testing (194XX) Report (After FY 1991).
- (7) DMIS CAS Tracking of Issued Noncompliance (19200) Report (After FY 1991).
- (8) Defective pricing lead sheets.
- (9) Flowcharts, record layouts, and IT audit reports on accounting systems for government contracts.
- (10) Historical pension cost information. At a minimum include the following information for each defined benefit plan by fiscal year:
  - (a) For contractors not separately calculating pension costs by segment – total costs incurred, the contractor's established allocation base to allocate pension costs to segments, and the government's participation in the allocation base, even if no pension costs were incurred for the year.
  - (b) For contractors calculating pension costs by segment – for each segment; total costs incurred, the portion of the costs allocated to contracts subject to CAS and FAR Cost Principles, and the year-end pension asset balance (market value), even if no pension costs were incurred for the year.

(11) Cumulative Allowable Cost Worksheet (CACWS) information described in 6-711.3.

d. Maintain the permanent file in a convenient, accessible manner. Include steps in each current audit to identify informa-

tion of the type described above which should be removed from the current file and placed in the permanent file. Annotate the current audit working papers file to reference any information removed for retention in the permanent file. Auditors using the permanent file in connection with a current audit are also expected to identify permanent file information which is outdated or no longer considered useful for future assignments. Submit recommendations to the supervisory auditor for removal of such data from the permanent file.

e. Auditors often refer to prior current files as frequently as the permanent files. This is especially true with indirect cost audit files that contain audited contract cost information. Accordingly, where the current file contains information that would likely be useful in the performance of future audits and it is not practical to transfer the data to a separate permanent file, maintain and properly reference the current file as part of the permanent file.

#### 4-405.2 Current File

a. The current file usually consists of working papers which have limited use on future assignments. DCAA Forms 7640-19a, b, and c are the Agency-wide Working Papers Indexes and provide a concise summary of items generally found in audit working papers.

b. Transfer information contained in the current file to the permanent file if there is anticipated need for the information on other current or future audits.

c. In preparing current file working papers, do not unnecessarily duplicate information located in the permanent file. Frequently the most expeditious method is to reference the permanent file data to the current file.

d. In certain situations a current file may become part or all of the permanent file (see 4-405.1.e.)

#### 4-406 Copies of Contractor Data in Working Papers

a. When considering the extent of the contractor's data that should be copied and retained in the working paper files, use the following guidelines:

(1) Keep copies of contractor financial records and documents to the minimum necessary to support the information obtained and the conclusions reached. Consider the continuing availability of source documents and contract data retention requirements when deciding whether to reference or reproduce contractor source documents.

(2) Where a particularly sensitive or material audit conclusion hinges on key source documents and referencing would not provide sufficient evidence of the content, include copies in the working papers. This same consideration applies when the audit results can give rise to a government claim against the contractor such as an assertion of defective pricing or an allegation of CAS noncompliance. In these situations, the contractor data should be retained in the working paper files for consideration by the contracting officer in his/her decision making processes. More routine audit conclusions may be sufficiently documented by reference and extraction of pertinent information.

(3) Recognize contractor concerns about reproducing copies of sensitive financial or other operating information. Instead of making copies, take notes or extracts if this will satisfy the government auditing standards and the needs of the contracting officer can be accomplished with a reasonable expenditure of audit effort.

b. The contractor must provide reasonable access to all records and corroborative documentary evidence necessary to achieve the audit objective. If the auditor is precluded from performing procedures considered necessary and material in the circumstances, including reproducing contractor records and documents, follow Agency access to records guidance (see 1-504).

c. Scanned Documents. The decision to transfer hardcopy documentation to electronic form (scanning) is a matter for auditor judgment. When presented as evidence in litigation, the courts will allow a document reproduced from electronic format to be treated as an original. Special care must be taken to avoid any alteration of the data, or appearance of alterations. DCAA scanner software will default to saving scanned documents as image files, which cannot

readily be modified. The software also has the capability to convert a scanned document to Optical Character Recognition (OCR) form. OCR scans are subject to transcription error and may easily be changed in word processing and spreadsheet programs. Therefore, the image format should generally be used as a means to scan audit documentation such as correspondence, invoices, travel vouchers, quotes, and similar records.

#### 4-407 Computer-Aided Working Papers

a. Agency standard naming conventions (see 4-403h) should be carried throughout the audit working paper package, including local storage of the completed assignment official records and the corresponding audit report. As with any audit assignment, the integrity of our audit working papers must be maintained; this is vital with electronic audit files. During an audit, many interactions take place between an auditor, other team members, technical specialists, the supervisory auditor, and the FAO manager. The following requirements apply to the audit workflow process and incorporate standard procedures to protect working paper integrity, specifically the integrity of the official electronic working papers.

b. In-process Procedures (Interim): During the performance of an audit, the auditor must coordinate his/her work with the audit supervisor. This includes interim guidance as well as obtaining supervisory review and approval of individual working papers. This requires that electronic files be accessible to audit supervisors. Within DCAA, several means to transmit electronic files between parties are available. These include:

- Physical delivery of files on diskette or other removable media
- Sharing access to files through common LAN drives or networks
- E-mail transmittal
- FTP (File Transfer Protocol)
- DCAA Intranet

When an electronic audit file is returned to the auditor after supervisory review, the auditor is responsible for ensuring that only the most current audit file, i.e., the reviewed file, is included in the audit package. A copy of the file should be created

before sending the original to the audit supervisor. This provides a temporary backup, until the approved file is returned. At that time the copy file should be deleted. If Windows Explorer was used to make the initial copy, it will automatically insert the term “copy of” into the new file name when the file is copied and pasted into the same folder. The auditor should then provide the original electronic working paper file to the supervisory auditor for review. As part of this process, the auditor may consider enabling embedded software functions to track any changes made to the files.

c. **Work In-Process Backup:** The most important computer proficiency discipline is the daily backup of current work in-process files. Files can be lost or destroyed; hard drives fail; and entire computers are sometimes stolen. Such occurrences could result in loss of the entire in-process electronic working paper package. To minimize such disruptions, the following procedures should be followed.

(1) A backup copy of in-process electronic audit files will be made at least daily. The auditor may employ file compression techniques if desired.

(2) Auditors using portable laptops must ensure that backup files are not stored with the laptop computer (i.e., carrying bag) to avoid both being concurrently lost. The backup copy(s) should be stored in a location where loss or damage is unlikely to occur.

(3) An in-process backup set of all assignment audit files will be maintained until the entire audit and review is completed and the final electronic working papers have been stored and backed up.

d. **Completed Working Paper Packages – Final Storage:** When an audit package is completed and ready for storage, the following final procedures are required.

(1) A hardcopy folder will be established to consolidate and store assignment working papers. Working papers include electronic media as well as hardcopy working paper documents which are not practical to store electronically. In making a decision whether or not it is practical to scan hardcopy items rather than maintain paper copies, the following factors should be considered: how long it will take to scan

the hardcopy items; how often the item will be used; and any scanning preferences or guidance provided by the supervisor, FAO, or region.

(2) All electronic working papers will be backed up and then the original files moved from the auditor’s personal computer or LAN drive and placed on a removable storage medium that will be placed in the working paper package. The auditor will maintain the backup files until a final permanent backup is created from the original files during the closing actions. APPS software should be used to create a compressed self-extracting (executable) archive in accordance with the procedures required by 4-407e.

(3) These electronic files are official audit working papers; any copies of these files maintained on the auditor’s hard drive must be renamed or otherwise designated as back up or nonofficial copies. The designation of “Final” must be removed from any files stored on the auditor’s hard drive or on LAN drives accessible by the FAO staff.

(4) The removable medium must be labeled and, as a minimum, the label must include:

- The complete assignment number.
- A brief assignment description, such as:  
2441-20XXB21000001

Audit of XYX Proposal for Multicolored Widgets

(5) The package is then provided to the supervisory auditor/FAO manager for final review and completion of the associated audit report. Printed copies of electronic working papers that are included in the package must match the versions that are included in the electronic media.

(6) As AICPA guidance makes clear, the audit report is not a working paper. Therefore it is not subject to the requirement that superseded working papers be retained in the file (see 4-402d). The audit report summarizes and reports the Agency’s conclusions on the Subject of Audit, based on the data and analysis documented in the working papers. Before an audit report is issued, all significant differences of opinion on matters of fact, interpretation of audit guidance, and application of audit guidance to the disclosed facts should have been resolved.

- When full agreement is reached, it is not necessary to document the opinion, or portion of an opinion, that was shown to be incorrect or inappropriate to the audit.
- If minor differences which do not change the report opinion or significantly change the dollar value of questioned or unsupported cost remain, they may be documented in the working papers.
- If an unreconciled difference of opinion would materially change questioned costs or change the report conclusion (for example, from unqualified to qualified or adverse), the issue should be elevated to the next higher level of management. Resolution should fully address and document any issues or questions raised by the auditor or supervisor.

The official file should not contain multiple audit report drafts that differ materially. Only the final report and its predecessor cross-referenced draft should be retained in the official file.

e. Each FAO must have written closing action procedures to ensure that appropriate Agency software is used to save and back up all final electronic working papers. The procedures should identify what types, if any, of electronic working papers will be made available for routine unofficial use and when they will be deleted, and should ensure that both the copy stored in the working paper package and the permanent backup copy are included with the working paper package when it is sent to storage. The procedures should also include the following elements.

(1) The final electronic version of the draft audit report (containing all changes to the draft except removal of the cross references and final spelling and format changes) must be cross-referenced (see 4-403i.(3) & 4-403j.) to the working papers and included in the working paper package. An electronic version of the acknowledgment letter should also be retained in the audit working paper package.

(2) The final audit report electronic file must be stored with the working papers. An additional copy should be stored uncompressed with the executable file for easy reference. Currently the APPS can be

used to create a copy of the draft audit report for final processing. The copy created by APPS is named "01 - Final Audit Report.doc." This file is processed to accept/reject tracked changes, remove cross-references and comments, remove hyperlinks to other documents, unlink document variables, and make final formatting changes before the report is printed out and signed. Once an audit report is signed, the electronic document should immediately be modified to indicate who signed it, and it should be password protected. There is no need to document the password in the working papers since its only function is to prevent inadvertent changes and it does not prevent using the document contents in a new document which can accept changes. The electronic file should then be renamed to uniquely identify that file as the official report according to the convention "01 DCAA Report [RORG-ASSIGNMENT NO.]-Final.doc" and changed to a read-only file. Only this file should be stored, transmitted, or otherwise used for official purposes.

(3) Scanning the signed signature page is required for all DCAA audit reports. The signed signature page should be scanned in accordance with applicable Agency or regional scanning instructions. For audit packages, the scanned signature page should be named the same as the audit report (see above) with "-sig" added and a .TIF extension (if in the .TIF format) (i.e., 01 DCAA Report 01101-2002X10100389-Final-sig.tif). The scanned image of the signature page must be stored with the working paper package, however there is no requirement to make the file a part of the APPS generated executable file and it may be included separately on the CD containing the APPS generated executable file.

(4) The following copies of the final electronic working papers (which should include the APPS generated executable file, a separate uncompressed copy of the final audit report, and the scanned signature page if not included in the compressed file) are required:

(a) The Official Working Paper Electronic Files (compressed as required, read-only and self-extracting) will be stored on a single session CD with the official working paper file folder. The CD is for use as the

official copy of the electronic working paper files and for creation of new back-ups. The compressed file must be identified as “-Final” in its file name.

(b) The Official FAO Archive Copy will be stored separately. The FAO archive copy of the electronic working paper files must be maintained as long as the original. It must also be stored separately from the Official Working Paper Electronic Files, such as in a controlled or locked file cabinet. This copy is to be used only if the original files become lost or damaged. The compressed working paper file must include “-Archive” in its file name.

(5) The following process shall be used to create these archive copies:

- The end user accesses the audit working paper files using APPS. This could be any member of the DCAA work force. It is critical that whoever is assigned this responsibility be appropriately trained, including training in APPS.
- Select the Admin Functions within APPS. Ensure that a backup has been made using the Daily Backup before proceeding.
- Select the Save As Archive. This will create the final official executable file (\*.archive.exe) that is ultimately stored within the completed audit folder. Then complete (a) and (b) below.

(a) Make a copy of the above executable file (\*.exe), final audit report file, and the scanned signature page file (if not included in the executable file) on a single session CD-ROM (type CD-R). Using your CD writing software, assure that the file is renamed to include “-Final” in the file name (by pressing the F2 Key and renaming the file while it is highlighted) and that the CD is closed at the end of the session. This will be the Official Electronic File. This copy must be tested at this point to ensure that it properly reopens.

(b) Make another copy of the above executable file (\*.Archive.exe) and other files on another single session CD-ROM (type CD-R). Using your CD writing software assure that the CD is closed. This will be the Official FAO Archive Copy (original back up). This copy must be tested at this point to ensure that it properly reopens.

Note: At the discretion of the FAO additional copies may be created and made available for routine unofficial purposes.

(6) After the final electronic working paper archive and back up copies are created, they must be opened and read to ensure they were not corrupted during the copying or compressing process.

(7) Ensure the electronic files (stored on single session CD-ROM's) are securely enclosed in the working paper package. The use of sleeves or other appropriate techniques should be employed to ensure the electronic files are not separated or lost from the working paper package. Each FAO should ensure strong controls are in place to protect the integrity of the official records/files as well as their physical security. The completed folder will be then be stored consistent with standard FAO procedures.

#### **4-408 Computer-Aided Audit Applications**

a. A computer-aided audit application is any audit task that has been automated using a software program. Any application that is developed must be tested before it is used. The extent and type of testing should be based on the complexity of the application and the inherent risk when relying on the results generated.

b. Audit applications done with a computer must fully satisfy the requirements of 2-305 and 4-402b. Thus, working papers prepared with the aid of a computer should be documented in the same manner as those prepared manually. They should clearly describe the data and procedures employed in the computer application.

c. The amount of documentation will vary depending on the particular computer application employed; however, the data and procedures used in the application must be sufficiently documented and properly retained to satisfy the requirements of 4-402b and to facilitate the re-creation of the application. Examples of matters that may need to be documented to fully explain the computer-aided audit work are (1) parts of the computer procedures used that are needed to understand and validate the main output such as formulas used in spreadsheet-type applications or in calcu-

lated columns of tabular schedules, (2) detailed schedules supporting summary schedules, and (3) the input data if it is not shown in the output. Depending on the application, the required documentation may be in the form of supplementary printouts from the computer application program or explanatory annotations by the auditor.

d. Proper training, planning, and testing are important factors in ensuring that computers are effectively used and in minimizing the risk of generating inaccurate results. However, just learning about proper design methods and good construction techniques in developing an audit application provides no guarantee that the results will be error-free. Adequate control features need to be identified, designed, and incorporated into the documentation, data entry, processing, and output portions of an audit application. For example, the following control activities could be used for spreadsheet applications, where appropriate:

(1) Print a listing of the formulas and relationships.

(2) Attach instructions and identification data with the spreadsheet application.

(3) Create back up files.

(4) Use the software protection/locking features to protect formulas and overall structure.

(5) Use record counts, data totals, hash totals, or other control totals.

(6) Calculate key balances using two alternative methods and then compare the results to make sure they are equal.

(7) Use range and reasonableness check numbers to confirm totals.

(8) Run test data and review the output for accuracy.

e. Store the data supporting a computer-aided audit application on reliable computer media (e.g., single session CD-ROM, magnetic tape, etc.) labeled with the appropriate audit assignment number. Take necessary precautions to adequately store and protect the electronic files.

f. Supervisory review to ensure compliance with the auditing standards applies to computer-aided audit applications just as it applies to any other type audit application. The reviewer must evaluate each applica-

tion based upon its objectives and the relative sensitivity of the audit conclusions.

#### **4-409 Revisions to the Audit Working Papers after the Audit Report is Issued**

Under the AICPA auditing standards, additional audit procedures and revisions to working papers may be necessary after audit report issuance when, subsequent to the date of the audit report:

the auditor concludes that one or more procedures considered necessary at the time of the audit, in the circumstances then existing, were omitted.

the auditor becomes aware that additional facts regarding the subject of audit may have existed at the report date, and such facts might have affected the report.

relevant and material developments or events have occurred (e.g., final determinations or resolutions of contingencies or other matters disclosed in the audit report or which had resulted in a departure from the auditor's standard report). See 10-214.1 for guidance on supplemental audit reports in this situation.

a. The auditor should revise or supplement working papers after report issuance only if it serves a useful purpose, e.g., the audit issues are still outstanding/being negotiated or there is risk that the audit may be used to settle disputes. When working paper revisions are necessary, the working papers should contain a concise explanation of the circumstances and resolution of the issues involved. Revisions should be undertaken only when they are necessary or useful to the requestor or other likely report users. Guidance on audit report revisions is contained in 10-214.

b. When revisions to working papers are needed after the audit report has been issued due to application of previously omitted procedures, additional facts, or to address subsequent events, the auditor should take prudent measures to ensure that the update will not be mistakenly viewed as having been part of the original work package at the time the report was issued. The auditor should ensure that the update:

- is clearly distinctive from the original content;

- fully documents the circumstances leading to the additional effort;
- contains a lead schedule summarizing the cost elements/areas evaluated;
- contains structured notes or on-page notes as appropriate (see 4-403.f), and
- properly reflects the dates that the additional procedures were performed. Dates must be incorporated into the working papers.

W/P A and the lead schedules for the changed cost elements/areas evaluated should be annotated with the revised recommendations/conclusions, if any, and cross-referenced to the working papers supporting the update.

#### c. Consideration of Omitted Procedures After the Report Date

(1) When an auditor concludes that a procedure considered necessary at the time of the audit in the circumstances then existing was omitted from the audit, the auditor should assess the importance of the omitted procedure to his/her present ability to support the previously expressed opinion or conclusions regarding the audit taken as a whole. A review of the working papers, discussion of the circumstances with the personnel involved in the audit (i.e., supervisory auditor, requestor, contracting officer) and others, and a reevaluation of the overall scope of the audit may be helpful in making this assessment. For example, the results of other procedures that were applied may tend to compensate for the procedure omitted or make its omission less important. Also, subsequent audits may provide audit evidence in support of the previously expressed opinion.

(2) If the auditor concludes that the omission of a procedure considered necessary at the time of the audit report in the circumstances then existing impairs his/her present ability to support the previously expressed opinion or conclusions regarding the audit, and the auditor believes there are persons currently relying, or likely to rely, on the report, the auditor should promptly undertake to apply the omitted procedure or alternative procedures that would provide a satisfactory basis for the opinion or conclusions.

(3) If the previously omitted procedure or alternative procedures cannot be ap-

plied, the auditor should discuss this matter with the supervisor and/or FAO manager to determine an appropriate course of action concerning responsibilities to the requestor, contracting activities, or other individuals who may rely on the report.

(4) If the additional procedures disclose that the report opinion, conclusions, or recommendations must be revised, follow the reporting guidance in 10-214. If no report revision is necessary, annotate the working papers to explain why this is the case.

#### d. Subsequent Discovery of Information Affecting the Audit Report Results.

(1) If, subsequent to issuance of an audit report, the auditor becomes aware of facts or events that would have been evaluated during the course of the audit, had they been known at the time, the auditor should promptly:

undertake to determine whether the information is reliable, and

assess whether its impact may be material.

The information at issue may have come into existence either before or after the audit report date. In any case, the auditor should discuss the matter with the contractor at any management level deemed appropriate, and request cooperation in whatever evaluation may be necessary.

(2) When the subsequently discovered information is found to be reliable, the auditor should take action in accordance with the procedures described in the subsequent paragraphs if the nature and effect of the matter are such that:

(a) the report would have been affected if the information had been known at the date of the report and had not been reflected in the audit; and

(b) the auditor believes there are persons currently relying or likely to rely on the audit report who would attach importance to the information.

Consideration should be given, among other things, to the time elapsed since the audit report was issued. When the auditor has concluded, after considering (a) and (b) above, that action should be taken to amend the opinion, conclusions, or recommendations in the original report, a supplemental report should be issued in accordance with 10-214.

(3) If the effect on the audit report of the subsequently discovered information cannot be determined without a prolonged evaluation, the issuance of a supplemental audit report will necessarily be delayed. When it appears that the information will require a supplemental report, appropriate disclosure would consist of notification to the requestor and any other persons who are likely to rely on the audit report that a supplemental report will be issued upon completion of an evaluation.



**4-500 Section 5 --- Using Information Technology (IT) in Contract Auditing****4-501 Introduction**

a. This section describes how IT can assist in audit of contract costs being estimated and/or incurred by contractors (to include internal control audits), and ways available to obtain related audit assistance. It includes policy and procedural guidelines for using both DCAA and non-DCAA IT resources for technical audit applications.

b. Sections 5-400 and 5-1400 along with the Information Systems (IS) Auditing Knowledge Base available on DCAA's Intranet, include general background and orientation material on IT, Information Systems (IS), and related terminology. More specific guidance on contract audit objectives related to IS includes:

- (1) Evaluating IS General Internal Controls (5-400).
- (2) Evaluating IS Application Internal Controls (5-1400).
- (3) Auditing the economy and efficiency of contractor IT operations (C-400).

**4-502 Policy on Use of IT****4-502.1 General Criteria for Using IT in Audit Applications**

a. Auditors are capable of performing many audit tasks using IT, and DCAA strives to take full advantage of this capability. The growing cost and scarcity of auditor time coupled with increasing economy and efficiency of IT can make the choice of using it increasingly cost-effective.

b. IT resources available to DCAA auditors include any computer system and software from (1) the contractor that has submitted the data, (2) DCAA regional and field audit offices, and (3) the Technical Support Branch (OTST) of the Technical Audit Services Division in Memphis, TN. If the data is written or copied to any electronic media, it can be accessed by any one of a number of data manipulation software tools. Due to the transportability of data, processing can take place at the contractor site or at any other processing site available to DCAA. Assistance in requesting and

obtaining contractor data is available from regional and OTST computer specialists.

c. Documents used to enter information into the computer for processing, certain computer files, or other evidential matter required by the auditor may exist only for a short period or only in electronic form. In some computer systems, input documents may not exist at all because information is directly entered into the system. A contractor's data retention policies may require the auditor to request retention of some information for his/her evaluation or to perform audit procedures when the information is available. In addition, certain information generated by the computer for management's internal purposes may be useful in performing analytical tests (e.g., system management facilities and statistical analysis system data).

d. Using IT may also provide an opportunity to apply certain procedures to an entire population of accounts or transactions rather than performing sampling. In addition, in some accounting systems, it may be difficult or impossible for the auditor to analyze certain data or test specific control activities without using IT resources.

e. When performing an audit the auditor should employ an appropriate combination of both manual and IT related audit techniques. In determining whether to use IT the auditor should consider such factors as:

- (1) the auditor's expertise, knowledge and experience with IT,
- (2) the availability of suitable IT resources,
- (3) the efficiency and effectiveness of using IT related techniques over manual ones,
- (4) time constraints,
- (5) integrity of the contractor's information system and IT environment, and
- (6) level of audit risk.

f. Certain planning steps should be taken in preparing for the application of selected IT related audit techniques such as:

- (1) setting objectives for using IT,
- (2) determining the accessibility and availability of IT resources and data,

(3) defining the procedures to be taken (e.g., statistical sampling, recalculation, confirmation, etc.),

(4) defining output requirements,

(5) determining resource requirements, and

(6) documentation of IT used including objectives, high-level flowcharts, and any operating instructions.

g. Data files, such as detailed transaction files, are often retained for only a short period of time; therefore, the auditor should make arrangements for the retention of the data covering the appropriate audit time frame. If the auditor plans to access the contractor's IT resources and data, arrangements should be made well in advance of the needed time period in order to minimize the effect on the contractor's IT environment. The auditor should also assess the effect that any changes to the IT environment may have on the use of IT in any audit applications. In doing so, the auditor should consider the effect of these changes on the integrity and usefulness of IT, as well as the integrity of any data used.

h. The auditor should obtain reasonable assurance of the integrity, reliability, usefulness, and security of IT through appropriate planning, design, testing, processing and evaluation of documentation. This should be done before reliance is placed upon the IT. The nature, timing and extent of testing is dependent on the availability and stability of any IT resources used.

i. The use of IT should be controlled to provide reasonable assurance that the audit objectives and the detailed specifications of the IT related audit activity have been met. Certain tests should be performed such as:

(1) a reconciliation of control totals,

(2) a review of output for reasonableness,

(3) a review of the logic, parameters or other characteristics of the IT, and

(4) a review of the contractor's IT general controls which may contribute to the integrity of the IT (e.g., program change controls and access to system, program, and/or data files) before the auditor relies upon system outputs.

j. Use of IT for audit applications should be sufficiently documented to provide adequate audit evidence. Specifically, workpapers should include a description of

the IT related audit activity, its planning and execution, and any output produced along with conclusions reached.

#### 4-502.2 Use of Contractor IT

a. With some computerized applications, access to contractor IT and data may be clearly essential for proper audit of costs incurred or proposed.

b. When possible, meet audit needs through adjustments to normally scheduled contractor computer runs rather than by special runs solely for contract audit purposes. Consider using reports or other records that are otherwise available before requesting special reports. This requires knowledge of the usefulness of available contractor output. Be receptive to suggestions of the contractor's personnel, so long as audit objectives are achieved effectively and efficiently.

c. In many applications the value of the audit benefit received will far exceed the net cost to the contractor. Often, added IT costs are more than justified by benefits accruing to the contractor, such as accelerated cash flow resulting from timely processing of progress payment requests or public vouchers, greater assurance of the accuracy of records, and reduced administrative support to contract audit requirements. Sample selections, cost reconciliations, and special analyses requested by the auditor often save the contractor other significant audit support efforts; and the audit data can often be used by the contractor's operating personnel to improve performance of their assigned tasks.

#### 4-502.3 Cooperation with Internal and Independent Auditors

Obtaining cooperation from the contractor's internal audit staff and/or independent auditors can facilitate the use of IT in auditing contract costs. These groups normally perform reviews of the company's IS and the data processed. They may often be aware of computer listings and/or general purpose computer programs within the system which will provide the specific information needed by the auditor. Obtain and use this assistance following the guidelines in 4-202 and 4-1000.

**4-503 Organizational Support of Auditing Using IT**

DCAA maintains a complete network of regional and Headquarters resources to help the field auditor determine the feasibility of using IT resources for audit applications and implementing those that are appropriate. (These resources are, for the most part, the same as are available to assist the field auditor plan and/or perform the types of audits noted in 4-501b.)

**4-503.1 Regional IS Auditors and Computer Specialists**

One or more auditors in the regional special programs offices are responsible for coordinating the overall implementation of auditing using IT policy and programs within the regions. These auditors provide technical guidance and assistance in performing audits using IT resources.

**4-503.2 Technical Support Branch**

a. OTST provides guidance and assistance for audit applications using IT resources. In addition, OTST is responsible for coordination and control of computer program development to ensure adequate dissemination of new and/or refined IT audit techniques

b. OTST provides technical guidance, support, and assistance for all aspects of audit applications using IT including internal control evaluations, information access, retrieval, displaying, and reporting; capacity planning; computer performance evaluation; and system tuning. OTST also provides direction and assistance in using generalized data management and data manipulation software packages (both commercially available and OTST developed) such as SAS, FOCUS, SQL, MSAccess, and Visual-Basic.

c. OTST provides guidance and assistance involving statistical sampling, correlation analysis, and improvement curves (EZ-Quant); use of economic data; Flexible Progress Payments; and Financial Accounting Standard Board (FASB) Statement 13. In addition OTST provides onsite and written directions for complex

applications of statistical sampling (Appendix B), correlation analysis (Appendix E), and improvement curves (Appendix F). OTST also supports financial capability audits by providing Z-Score and selected financial ratios on request (see 14-300).

**4-503.3 IT Related Training**

DCAA's general auditor training and career development plan includes courses designed to provide a basic understanding of Information Systems and Information Technology and the audit concerns associated with this environment. The courses are offered through the Defense Contract Audit Institute (DCAI) and conducted by OTST. More specialized courses, offered through both government and non-government sources, are available on an as-required basis.

**4-504 IT Audit Tools****4-504.1 Generalized Audit Software**

Generalized audit software is a computer program or series of programs designed to perform certain automated functions. These functions include reading computer files, selecting data, manipulating data, sorting data, summarizing data, performing calculations, selecting samples, and printing reports or letters in a format specified by the auditor. This technique includes software acquired or written for audit purposes and software embedded in information systems. When using generalized audit software, the auditor should take appropriate steps to protect the integrity of the contractor's data.

**4-504.2 Application Software Tracing and Mapping**

Application software tracing and mapping is the technique of using specialized tools to analyze the flow of data through the processing logic of the application software and document the logic, paths, control conditions, and processing sequences. Both the command language or job control statements and programming language can be analyzed. This technique

includes program/system: mapping, tracing, snapshots, parallel simulations, and code comparisons. When using application software tracing and mapping, the auditor should confirm that the source code being evaluated generated the object program currently being used in production. The auditor should be aware that application software tracing and mapping only points out the potential for erroneous processing; it does not evaluate actual data.

#### **4-504.3 Audit Expert Systems**

Audit expert systems or decision support systems are tools that can be used to assist auditors in the decision-making process by automating the knowledge of experts in the field. This technique includes automated risk analysis, system software, and control objectives software packages. When using audit expert systems, the auditor should be thoroughly knowledgeable of the operations of the system to confirm that the decision paths followed are appropriate to the given audit environment/situation.

#### **4-504.4 Test Data**

Test data are simulated transactions that can be used to test processing logic, computations and controls actually programmed in computer applications. Individual programs or an entire system can be tested. This technique includes Integrated Test Facilities (ITFs) and Base

grated Test Facilities (ITFs) and Base Case System Evaluations (BCSEs). When using test data, the auditor should be aware that test data only point out the potential for erroneous processing; this technique does not evaluate actual data. The auditor also should be aware that test data analysis can be extremely complex and time consuming, depending on the number of transactions processed, the number of programs tested, and the complexity of the programs/system. Before using test data the auditor should verify that the test data will not affect the contractor's live system.

#### **4-504.5 Utility Software**

Utility software is a computer program often provided by a computer hardware manufacturer or software vendor and used to support running the system. This technique can be used to examine processing activity; test programs, system activities, and operational procedures; evaluate data file activity; and analyze job accounting data. When using utility software, the auditor should confirm that no unplanned interventions have taken place during processing and that the utility software has been obtained from the appropriate system library. The auditor should also take appropriate steps to protect the integrity of the organization's system and files since these utilities can easily damage them.

**4-600 Section 6 --- Audit Sampling****4-601 Introduction**

This section states the procedures for audit sampling on a judgmental or statistical basis. Detailed guidance is in Appendix B, Statistical Sampling Techniques.

**4-602 Sampling**

Audit sampling can be classified into the two main categories of estimation and acceptance sampling. The sampling method used depends on desired audit objectives.

a. Estimation sampling provides an answer to the question of either how many or how much, and can be further classified into sampling for attributes and sampling for variables. The purpose of attributes estimation sampling is to estimate the frequency with which items fall into certain categories (how many), such as compliance with internal controls. The purpose of variables estimation sampling is to provide an estimate of average or total value (how much), such as the total questioned amount in a bill of materials. Estimation sampling provides a point estimate of the actual frequency (in attributes sampling) or value (in variables sampling) that exists in the universe or stratum. It also enables the auditor to assess the sample's reliability, thereby helping the auditor determine how much reliance to place on the point estimate. This feature, consisting of an estimate of the sampling error, shows how far the point estimate might be from the value obtainable from total review.

b. Acceptance sampling, which can also be subdivided into attributes or variables sampling, differs from estimation sampling in that its purpose is simply to either accept or reject a statement of condition. In this case, consideration of sampling error is incorporated in the acceptance criteria. Acceptance sampling is not intended to provide information regarding how good or bad a statement or representation might be, though at times it might serve that ancillary purpose.

c. Throughout this manual the auditor is advised to "test check" a procedure, to make verifications "on a selective basis" or

to review a "representative number" of transactions or items. These instructions recognize that a complete review of all the transactions which support a proposal, claim, or other form of financial representation generally is unnecessary or impractical. Review of all representations may be required when a few transactions or items of large amounts are involved or when it is necessary to develop detailed information devoid of sampling error, such as in the case of support for legal action. In most instances, however, it is possible to support a professional opinion regarding a contractor's representation by reviewing a limited number of transactions on a sampling basis.

d. It is usually more efficient to group or stratify items to be tested into two or more categories, one group or stratum to be reviewed in its entirety and the remaining groups or strata to be reviewed on a sampling basis. When an item has been selected for review, the review must be completed, regardless of difficulty, to provide statistical integrity of sample results. When initial examinations disclose excessive misrepresentations or frequency of error, it may be appropriate to discontinue the review, abandon statistical interpretation of sample results, and issue an opinion on the basis of the strength of the evidence provided by the initial examinations. In the case of acceptance sampling, the auditor might develop a sampling plan that provides for curtailment of sampling when no significant error appears in a preliminary sample, as explained in the material on the use of preliminary samples in Appendix B.

**4-603 Scope and Degree of Testing**

The scope and degree of testing is a matter of judgment by the auditor. The decision will be influenced by prior experience, materiality, sensitivity, and other factors, including recognition of the important factor that only a statistical sample can be defended as truly objective. In selecting the items to be tested, and in determining the extent of the examination, the following guidelines should be considered:

(a) All large transactions should be considered for examination (the meaning of "large" will vary; thus, a \$1,000 item in a \$10,000 claim would deserve attention, but the same item would not be "large" in a \$10 million indirect cost pool in which the government shares a small percentage).

(b) All transactions of an unusual or sensitive nature should be reviewed.

(c) More extensive tests may be necessary in areas where procedures or internal controls are known to be weak or where deficiencies were disclosed in previous audits, where errors or items of a questionable nature are more likely to occur in certain departments or in records produced by certain categories of employees, during certain periods of reorganization, or where personnel are assigned unfamiliar tasks.

(d) The lapse of time since previous tests should be considered.

(e) Special attention should be given to those areas where incorrect charges would have the greatest effect on the costs to the government.

(f) Trend information from previous audits should be considered.

(g) Other transactions should be tested where the total amount may be significant in the aggregate.

#### 4-604 Method of Selecting Sample Items

a. The method of selecting the sample items affects the interpretation of the results. The results of a randomly selected sample can be objectively applied to the stratum from which the sample is drawn because the sample items are drawn without regard for their possible outcome upon review. Judgmentally selected samples lack this feature because it cannot be indisputably demonstrated that some items in the strata are not favored for selection over others on the basis of their possible outcomes. Furthermore, only with random sample selection can the reliability of the sample results be determined.

b. A randomly selected sample, often referred to as a statistical sample because statistical principles can be applied to it, is one in which each item in a stratum has an equal probability (or chance) of being selected. More broadly, a statistical sample is one for which each item in the stratum has

a determinable chance of being selected. The manner of selection of the items must preclude any personal influence as to which items are included in the sample. Judgment and knowledge of the subject area, however, are necessary in defining the sampling unit and what constitutes an error or deficiency, in deciding where to stratify, and in designing the sampling plan. There is no limit on the amount of judgment that is used, provided it is not allowed to influence the selection of sample items. Random sample selection procedures are discussed in Appendix B.

c. Statistical sampling for variables (estimation sampling) can be performed in two ways, depending on selection probabilities for individual sampling units. With physical unit sampling, each item (physical unit) in a stratum has an equal chance of being selected. With dollar unit sampling (DUS), known outside the audit context as probability proportional to size sampling (PPS), each item has a selection probability that is proportional to its dollar (absolute value) size. This translates to an equal chance of selection for each dollar in a stratum. DUS is sometimes referred to as monetary unit sampling (MUS), reflecting the fact that the sample selection method is adaptable to any measure of size. Except for the option of a stratum for total review, the need for stratification based on physical unit magnitudes is eliminated in DUS. The appropriate use of these two methods is discussed in Appendix B.

d. A judgmental sample is one in which individual judgment has influenced the selection of sample items. Although judgmental sampling results cannot be used to make totally objective inferences regarding conditions of the entire stratum or universe, they might be adequate in some circumstances to form an audit opinion. For example, if a judgmental sample reveals a high degree of inaccuracy in a price proposal, the entire proposal may be rejected. Although a judgmental sample may be acceptable, there is no way of estimating the reliability of the results or guaranteeing their objectivity. Such qualities are available only through statistical sampling or total review of the stratum or universe.

**4-605 Sampling Policy**

a. Because of its many advantages, including objectivity and overall defensibility, statistical (probability) sampling will be used, if feasible, wherever an audit involves tests or selected transactions or items in order to express an opinion regarding the entire area (universe) from which the selection was made. If statistical sampling is not used in these circumstances, an explanation should be given in the working papers.

b. Where statistical sampling methods are used, the report may include a statement to that effect. In expressing an opinion as to the results of sampling for variables (estimation sampling), only one projected value or amount will be used, that single amount (point estimate) having been developed from the sample results by either the difference (or mean) method or the ratio method as discussed in Appendix B. No comments will be made as to confidence level (assurance) or confidence interval (tolerance). These comments and supporting data and computations will, however, be included in working papers.

c. For audit purposes, items stratified for detailed or more intensive examination will not be considered a part of the sample area (universe); hence, the results will be appraised separately from the statistical evaluation of the sample result.

d. Where appropriate, the statistical sample result should be projected to the universe from which the sample was selected.

e. Computer systems will be used to the maximum in the stratification, random selection of sample items, and statistical

evaluation of sample results. See 4-606 for a description of sampling software.

f. The use of statistical sampling methods should be discussed in advance with statisticians or other appropriate personnel of the contractor wherever possible. The purpose of these discussions is to establish, in advance, mutual acceptance of the sampling procedures; however, no prior commitment should be made regarding sample reliability.

**4-606 Sampling Software**

There are a number of computer software packages available to assist the auditor in data retrieval and in stratifying, selecting, and appraising the results of a sample.

a. EZ-Quant is a collection of quantitative methods for which software has been written for use on microcomputers to perform quantitative analyses such as statistical sampling, correlation analysis, and improvement curves. Specific operational guidance is given in the EZ-Quant software "help" documentation.

b. The electronic Selection Program (ESP) is available for performing DUS. This microcomputer software package has other capabilities related to contractor data files and workpaper preparation.

c. DATATRAK is a generalized software package this is installed on contractors' systems to retrieve, sort, and summarize large volumes of data. Specific operational guidance is in DCAAP 7641.89. Information necessary to run the program is supplied by the auditor and input to the program at execution time.

## **4-700 Section 7 --- Responsibilities for Detection and Reporting of Suspected Irregularities**

### **4-701 Introduction**

This section covers procedures, audit guidance, and responsibilities relating to fraud, other unlawful activity, anticompetitive practices, and voluntary disclosures. For unsatisfactory conditions not covered by this section see 4-800.

### **4-702 Suspected Fraud and Unlawful Activity --- General**

#### **4-702.1 General**

a. When auditing a contractor's records in accordance with government auditing standards, auditors may encounter, or receive from other sources, information constituting evidence or causing suspicion of fraud or other unlawful activity. (Examples of other unlawful activity include violations of the Anti-Kickback Act, anticompetitive (antitrust) practices, and illegal political contributions.) Sources for such information may include company employees, disgruntled participants, or others making allegations by letter, telephone, personal visit, or through a third party. Such information may pertain to acts of:

- (1) military personnel or civilian employees of the government in their relations with the government.
- (2) military personnel or civilian employees of the government in their relations with individuals or firms.
- (3) individuals or firms in their business relations with the government.
- (4) individuals or firms in their business relations with other individuals or firms doing business with the government.

b. Definition. For purposes of this chapter, the term "fraud" or "other unlawful activity" means any willful or conscious wrongdoing, including, but not limited to, acts of cheating or dishonesty which contribute to a loss or injury to the government. Some examples are:

- (1) falsification of documents such as time cards or purchase orders.
- (2) charging personal expenses to government contracts.

(3) submitting false claims such as invoices for services not performed or materials not delivered.

(4) intentional mischarging or misallocation of costs.

(5) deceit by suppression of the truth.

(6) bribery.

(7) corrupt payments which violate the Foreign Corrupt Practices Act.

(8) theft.

(9) a government employee acquiring a financial interest in or seeking employment with a contractor over whom the employee exercises oversight.

(10) kickbacks.

(11) any unlawful or fraudulent acts resulting from accounting classification practices designed to conceal the true nature of expenses, e.g., classifying unallowable advertising or entertainment costs as office supplies.

(12) product substitution or false certification that tests were performed.

(13) any attempt or conspiracy to engage in, or use, the above devices.

#### **4-702.2 Auditor Responsibilities for Detecting and Reporting Fraud**

a. The assessment of the risk of material misstatement due to fraud is a cumulative process that (1) includes a consideration of risk factors individually and in combination, and (2) should be ongoing throughout the audit. In determining contractor compliance with laws and regulations, government auditing standards require auditors to design audit steps and procedures to provide reasonable assurance of detecting errors, irregularities, abuse, or illegal acts that could:

- have a direct (or indirect) and material effect on contractor financial representations or the results of financial-related audits, or
- significantly affect the audit objectives.

Auditors should also exercise:

- due care in planning, performing, and evaluating the results of audit procedures, and
- a proper degree of professional skepticism to achieve reasonable assurance



that material unlawful activities or improper practices are detected.

Under the concept of professional skepticism, an auditor neither assumes that management is dishonest nor assumes unquestioned honesty. Rather, an auditor recognizes that conditions observed and evidential matter obtained, including information from prior audits, need to be objectively evaluated to determine if contractor financial representations are free of material misstatements. Many aspects of a DCAA auditor's responsibilities, particularly as set forth in Chapters 6 and 9, require constant alertness to the possibility of fraudulent activities. This alertness, combined with a contractor's internal controls and the auditor's normally programmed tests of procedures and transactions, should provide a reasonable degree of assurance for disclosing fraud or other unlawful activity. (See also 4-702.3.)

b. Auditors are not trained to conduct investigations of illegal acts. This is the responsibility of investigators or law enforcement authorities. Auditors are responsible for being aware of fraud indicators, vulnerabilities, and potentially illegal expenditures and acts associated with an audit area (see 4-702.3a. and b.). When an auditor obtains information that raises a reasonable suspicion of fraud or other unlawful activity that has not been previously disclosed to the government, an investigative referral should be initiated (see 4-702.4). (However, if such information relates to a contractor's voluntary disclosure, see 4-707.)

c. Issuance of an investigative referral should not be deferred until completion of the audit. Neither should it necessarily take place as soon as the auditor is confronted with a fraud indicator. The auditor should follow up on fraud indicators until he or she is satisfied either that an innocent explanation of the irregularity is not likely or no further relevant information can be generated through audit techniques. This is similar to the manner in which a tentative decision to question costs would be followed up. The auditor must avoid the appearance of conducting an investigation. If the auditor is in doubt about the propriety of a proposed audit step, guidance should be requested from

the supervisor or FAO manager. Audit support to investigations is covered in 4-702.6 and 4-702.7.

d. The following guidance applies when suspected irregularities are discovered by either government or contractor auditors during joint audits. Joint audits are discussed in 4-202.1e.

(1) As soon as there is a discovery of a suspected irregularity during the conduct of a joint audit, both the government and contractor participants in the audit should be notified. The contractor will have 30 days from the date of the discovery to make a voluntary disclosure to the DoD Inspector General. The disclosure must be made in accordance with the requirements of the Voluntary Disclosure Program as described in 4-707.

(2) Audit tasks from the joint audit plan pertaining to the suspected irregularity will normally be suspended until the 30-day time period has elapsed, or until the contractor notifies the government it does not intend to make a voluntary disclosure. Upon such notice, audit activities in the area will be subject to 4-702.4 procedures for determining whether a referral is required. Work on other tasks in the joint audit plan may continue.

(3) If the contractor makes a voluntary disclosure and is accepted into the Voluntary Disclosure Program by the DoDIG, it will be permitted to conduct an independent internal investigation of the suspected irregularity, in accordance with the provisions of the Voluntary Disclosure Program. Audit tasks from the joint audit plan pertaining to the disclosure will be suspended until that investigation is completed.

e. Suspected irregularities, whether discovered through audit steps and procedures; discovered by an auditor inadvertently, as in a conversation overheard; or disclosed to an auditor, either in person or through an anonymous tip, shall be recorded in the audit working papers and reported promptly to FAO management. It is not necessary to establish that the government has been defrauded before alerting investigators. Proving that an unlawful act has occurred is the responsibility of investigators and prosecutors.

**4-702.3 Fraud Indicators and Audit Procedures for Uncovering Fraud**

a. Auditors should be familiar with specific fraud indicators. DCAA course No. 1282, "Fraud Awareness Workshop," contains several case studies on fraud detection and a discussion of fraud indicators. In addition, examples of fraud indicators are included in the following publications issued by the DoDIG:

- Handbook on Fraud Indicators for Contract Auditors (IGDH 7600.3, APO, March 31, 1993)
- Role of the Contract Auditor in Criminal Investigations (IGDH 7600.2, January 1989)

In addition to the indicators shown in the publications listed above, specific fraud indicators, risk factors, audit tests, and procedures for the detection of fraud appear in the standard audit programs and in the listed CAM sections for the following audit areas:

Audit Area	CAM Reference
General	Figure 4-7-3
Internal Control Audits	5-100
Physical Observations	5-108a
Accounting for Material Cost	6-305
Storing and Issuing Materials	6-312
Labor Cost Charging and Allocation	6-404.6
Floor Checks	6-405.2/.3
Overtime	6-409.2
Consultant Costs	7-2105.1
Defective Pricing Audits	14-121
IT System Audits	5-400

b. The auditor should specifically assess the risk of material misstatement due to fraud and should consider that assessment in designing the audit procedures to be performed. Effective audit risk assessments and audits of internal controls are useful procedures for assessing risk of fraud against the government. Proper execution of audit programs together with adequate tests of contractor internal control systems should provide reasonable assurance that significant fraudulent and other unlawful practices are detected (see Chapters 5, 6, 7, and the Information Systems (IS) Auditing Knowledge Base on DCAA's Intranet).

The nature of audit procedures performed may need to be changed to obtain evidence that is more reliable or to obtain additional corroborative information. The extent of the procedures applied should reflect the assessment of the risk of material misstatement due to fraud. For example, increased sample sizes or more extensive analytical procedures may be appropriate. Application of auditor judgment and applicable coordination with the supervisor is important to assure that any added steps are value added, are an efficient use of audit resources, and will specifically address the added risk of material misstatement due to fraud or error.

c. Treat as a possible audit lead any allegation received from outside sources, such as telephone calls, anonymous letters, and contractor employees. If there is further evidence available at the FAO to support the allegation and a reasonable basis to suspect fraud or other unlawful conduct, report the suspicions in accordance with 4-702.4. If the allegation provides a reasonable basis to suspect fraud or other unlawful conduct, but there is no further corroborating evidence, relay the allegation using the DoD Hotline (4-702.4a(1)). A contractor's voluntary disclosure will not normally be treated as a potential fraud referral (see 4-707).

**4-702.4 Procedures for Referring Suspicions**

a. Upon encountering or receiving information which raises a reasonable suspicion of fraud, corruption, or unlawful activity (see 4-702.3) relating to a government contract:

(1) Promptly prepare a DCAA Suspected Irregularity Referral Form (DCAAF 2000), or utilize the DoD Hotline toll-free telephone number (800/424-9098) or the mailing address (Defense Hotline, The Pentagon, Washington, DC 20301-1900). If the irregularity does not affect DoD contracts, the matter may be reported to the inspector general of the agency most at risk.

Use of the DCAAF 2000 is the preferred method for forwarding this information. It specifies the information needed by investigators and provides for appropriate consideration of audit impact. A copy of

the DCAAF 2000 is included as Figure 4-7-2. The latest version of the DCAAF 2000 is available on the DCAA Intranet, the DIIS and the APPS.

(2) If the DCAAF 2000 is to be used, it should be obtained from either the DCAA Intranet, the DIIS or the APPS, completed, and submitted to your immediate supervisor. Fully describe the fraudulent condition to be reported and reference the procurement regulations or statutes that were allegedly violated. Include information on contractor efforts to hinder or obstruct audit work which uncovered the suspected fraud (see 4-708).

(3) Care should be taken to avoid unnecessary use of legal terminology or proliferation of enclosures beyond those necessary to explain the problem. The purpose of the DCAAF 2000 is to alert an investigator to a possible irregularity, not to establish that the reported irregularity is a violation of the law. The auditor's obligation to protect the contractor's records from unauthorized access requires that the distribution of documents which appear to provide evidence of impropriety be restricted. Evidentiary material should be made available to the investigator at the earliest opportunity after an investigation has been opened, preferably during the investigator's initial visit to the FAO.

(4) Place a reference to the draft DCAAF 2000 in the audit working papers to establish a record of events leading up to the decision to make a referral. The referral itself should be secured separately in a locked receptacle to prevent inadvertent disclosure (see 4-702.5d).

(5) Continue with assigned duties and pursue development of factual information as appropriate or indicated by 4-702.5. Coordinate any continuing evaluation with your supervisor or FAO manager.

b. Instructions for referring suspicions are contained in the DCAA Instruction on "Reporting Suspected Contractor Fraud and Other Contractor Irregularities" (DCAAI 7640.16).

#### **4-702.5 Audit Activities Subsequent to Referral --- Continuing Audits**

a. Following a referral, or after notification of the initiation of an investigation,

take no actions that would compromise the investigation. Do not attempt to establish wrongdoing (an investigative responsibility) nor inform the contractor that a fraud referral has been made. Audit scope may, after consultation with the investigative organization, be expanded to determine the impact of the suspected fraud or other unlawful activity on audit objectives. Do not expand audit scope for the sole purpose of gathering additional information to support an investigation. If audit activities relate to an area under investigation or litigation, coordinate with the cognizant investigative or prosecutive organization before taking any final administrative action. An example of such an audit activity is the issuance of final audit-determined indirect cost rates. Audit activities outside the area of investigative interest will continue unless the investigative organization requests in writing they be deferred or suspended. If it is believed the requested deferral will cause financial harm to the government or unnecessarily impede the audit mission, elevate the matter for management resolution between the respective organizations. Before any decision is made to defer or suspend an audit, coordinate the matter with Headquarters (OTS).

b. Furnish a copy of any resulting audit report to the appropriate investigative organization. Also, furnish any information developed later, relating to the suspected wrongdoing or similar misconduct, directly to the responsible investigative agency without filing a separate DCAAF 2000. Reference all future correspondence and/or updates with the DCAA case number assigned by OTS, and, if available, the case control number assigned by the investigative agency. In order that current, complete, and accurate information is available to the Department of Justice (DOJ), furnish the DCAA Justice Liaison Auditor (JLA), DCAA's representative to the DOJ, a copy of all unclassified audit reports or memorandums prepared in support of an investigation, voluntary disclosure, or similar demand assignment. The address is:

DCAA Justice Liaison Auditor  
Attn: OTS  
8725 John J. Kingman Rd., Suite 2135  
Fort Belvoir, VA 22060-6219

c. Suspicions of fraud or other unlawful activity may be so serious as to prevent the issuance of an unqualified audit report or lead to a recommendation that contract payments be halted pending resolution. If additional time is required to develop factual information for an audit impact determination, the final audit report can usually be delayed for DCAA-initiated assignments. (See 4-702.5a. and e. before issuing a report.) Examples of such assignments are operations audits, estimating system surveys, or postaward audits. However, when an audit report is scheduled for issuance within a specified time frame (e.g., a report on a price proposal audit) the suspected condition may have a serious impact on the auditor's ability to meet the due date. When this occurs:

- (1) Consult the regional office.
- (2) Contact the Plant Representative/ACO or the representative of a non-DoD agency, as appropriate, to explain the condition and arrange for an extended report due date. Do not do this, however, if the contracting representative may be involved in the suspected unlawful activity.
- (3) Qualify the report if a due date cannot be extended, and inform the requester by separate letter of the circumstances affecting the situation (but see 4-702.5a. and e.).
- (4) Question any costs improperly claimed as a result of the suspected wrongdoing (but see 4-702.5a. and e.).

d. Carefully protect and strictly control all information related to the suspicion of fraud or other unlawful activity. This is to protect the reputations of innocent persons and ensure that information is not prematurely or inadvertently disclosed to persons suspected of wrongdoing. Premature or inadvertent disclosure could compromise the government's efforts to gather needed evidence. Mark the DCAAF 2000 and all related DCAA reports and correspondence "FOR OFFICIAL USE ONLY" (unless a security classification is required). Control and protect all such information as follows:

- (1) During normal duty hours, keep the documents in an out-of-sight location if the work area is accessible to nongovernment personnel (e.g., contractor personnel).

(2) After duty hours, place the documents in locked receptacles such as file cabinets, desks, or bookcases.

(3) When such information is being disseminated outside DCAA, hand carry reports and correspondence between appropriate officials whenever practicable, or otherwise transmit them in a manner which will prevent inadvertent release to unauthorized persons.

e. Do not issue an audit report on any part of a representation containing a fraudulent claim without first notifying and coordinating with the cognizant investigative agency (see 4-702.5a). Normally there is no need to withhold an audit report unless it can be demonstrated that its issuance would hinder an investigation or prosecution. Before a decision is made to withhold an audit report, the FAO or region should coordinate the matter with Headquarters (OTS). Unless otherwise instructed, send the original audit report to the responsible contracting officer/ACO along with a separate cautionary transmittal memorandum regarding the suspected unlawful activity. See Figure 4-7-1 for an example. Do not make reference in the audit report to suspected irregular conduct or a referral for investigation, and do not send copies of the transmittal memorandum to other parties. In circumstances where government contracting representatives may be involved in the suspected unlawful activity, do not use the transmittal memorandum if, per discussion with the cognizant investigative agency, the information contained therein would interfere with a pending investigation.

f. It is DCAA policy that information relating to a matter referred for investigation will be protected and not released or disclosed to a contractor, or a contractor's employee, representative, or attorney. This policy is based on the need to avoid the disclosure of information which might impede or compromise an investigation. A regional director or head of a principal staff element may make a case-by-case exception to this policy after consultation with the cognizant investigator and OTS.

g. Representatives of a contractor seeking protected information might take unusual measures to contact the auditor away from the workplace. Such measures could

include telephoning or making an unannounced visit to the auditor's home. Whether the contact occurs at the workplace or elsewhere, do not discuss any aspect of a matter referred for investigation. Any contractor contacts, whether related to an investigation or normal audit activity, should occur at the auditor's or contractor's place of business during normal duty hours. If an attempt to contact the auditor outside normal working hours or workplace occurs, notify the region, OTS, and the cognizant investigative organization.

#### **4-702.6 Investigative Support Responsibilities**

The auditor's responsibility for detecting fraud ends with the submission of a Form 2000 or Hotline referral. DoD IG Joint Policy Memorandum No. 2 (JPM-2), which is enclosure 1 to DCAA Regulation (DCAAR) 7640.15, makes the investigative agency responsible for directing, monitoring, and reporting on the status of fraud investigations. Audit support to DoD investigative organizations is authorized by DoD Directive 7600.2, "Audit Policies," dated February 2, 1991. Specific guidelines concerning audit support of fraud investigations are contained in JPM-2. The provisions of JPM-2 were carefully developed to encourage cooperation between DoD investigators and auditors, and to clearly define the responsibilities of each organization. Offices furnishing support to investigative activities should be thoroughly familiar with the contents of this memorandum. Following are some of the regional, FAO, and auditor investigative support responsibilities:

a. Regions are to establish procedures, documented by regional instructions, which provide for regional oversight of the timeliness and quality of audit support to investigators.

b. Auditors should support formally constituted investigations when the investigators have submitted a written request for assistance to the cognizant FAO. Auditors will treat requests for investigative support as demand assignments and schedule them for completion on that basis. Such requests should include a list of the audit tasks needed to support the

investigation. If requested, the FAO will assist the investigative organization in framing the list of audit tasks being requested. This list may be amended periodically, depending on investigative developments or as deemed necessary by the auditor to properly fulfill his or her mission or function. A formally constituted investigation is one which:

(1) has progressed beyond the preliminary inquiry stage,

(2) has been assigned an investigative case number, and

(3) has resolved all issues regarding notification of the contractor under investigation.

It is the investigator's responsibility to notify the contractor that it is under investigation and that DCAA auditors are assisting. This should be done before DCAA provides support to a criminal investigation requiring access to contractor personnel or records located at the contractor's facility.

c. Auditors will provide prompt and effective support to investigators consistent with the auditor's role in the acquisition process. Auditors assigned to assist investigators will remain under the operational control and supervision of DCAA management. Auditors are not to perform clerical or other tasks outside the normal function of the auditing profession on behalf of investigators and are not to assume the role of an investigator.

(1) Auditors assigned to support an investigation are not required to meet contractor employees or other witnesses in situations where their safety may be threatened. If such unsafe conditions are expected, auditors may be asked to develop questions, but are not required to accompany the investigator. Requests for the use of DCAA resources to assist covert or clandestine investigations or operations must be elevated to DCAA Headquarters, ATTN: OTS.

(2) Investigators have authority (through inspector general or grand jury subpoenas and search warrants) to obtain documents not normally available to DCAA in performing its mission. When assigned to support an investigation, auditors will not have investigators use their authority to obtain, for DCAA's use, information or documents not related to the

investigation. Conversely, auditors will not use DCAA's authority to obtain for investigators information or documents not related to the investigation.

(3) Auditors assigned to a criminal investigative team will not, directly or indirectly, state or indicate that their presence at the auditee's premises is for any purpose other than to assist in a criminal investigation. To do otherwise could result in audit-obtained information being deemed inadmissible in court.

(4) When supporting an investigation, it may be necessary to audit companies that are not the target of the investigation. An example is the audit of a subcontractor to confirm or refute information provided by a prime contractor. If a company is not the target of an investigation, do not inform the company of the investigation or of the investigative nature of the audit.

d. Auditors will (1) provide government investigators and prosecutors ready access to applicable DCAA working paper files, including contractor-generated material contained therein, (2) list in the working papers or DCAAF 2000 file copies of working papers and other data provided to investigators, and (3) document in the working papers or DCAAF 2000 file meetings with members of governmental investigative agencies (see 1-405). See 4-702.5c., d., e., f., and g. for guidance on the protection of information relating to investigations.

e. If, within the course of exercising its existing authority, DCAA obtains custody and control of original documents (including contractor records) reflecting indicators of fraud or other unlawful activity, DCAA must immediately inform the cognizant criminal investigative organization so appropriate measures can be taken for the government to maintain custody and control over such documents.

f. Grand jury proceedings are criminal investigations officially conducted by the Department of Justice or an assistant U.S. attorney (AUSA) rather than a DoD investigative organization. An AUSA or DOJ attorney may also conduct a civil investigation into suspected contract fraud. In many cases, the trial attorney obtains services from an investigative agency such as the FBI. The investigator will then obtain

DCAA audit assistance. Although JPM-2 does not address DOJ trial attorneys, AUSAs or the FBI, it is DCAA policy that the obligations of the requester and auditor are the same as those specified in JPM-2.

g. Audit services to non-DoD agencies are furnished under cross-servicing agreements which provide for interagency billings. None of these agreements specifically provides for investigative support services. To ensure consistency, handle requests from non-DoD agencies for investigative support using the guidelines in JPM-2. Investigative support to non-DoD agencies other than the Department of Justice (DOJ) and the FBI is reimbursable, and this should be confirmed with the requesting agency before such services are rendered. Investigative support to DOJ and the FBI is reimbursable only to the extent that DOJ or FBI contracts are affected.

h. Audit support of investigations may consist of completing routine overhead audits or defective pricing audits of special interest to investigators. In these situations, report audit results using standard audit reports (see 4-702.5e., 4-702.8, and Chapter 10). However, certain requests for investigative support require effort not fitting the pattern of established audits. In these circumstances, consider the information needs of the requester in conjunction with the guidance in 10-1200 when issuing reports or memoranda in response to investigative support requests. Do not release results of these audits, including draft condition statements or recommendations, to the contractor before consulting with and obtaining the approval of the investigator. Discuss factual matters with the contractor only to the extent necessary to ensure accuracy. These procedures are necessary to prevent premature release of audit results which could compromise government actions regarding the condition under investigation.

#### **4-702.7 Control of Documents Obtained Under Inspector General or Grand Jury Subpoenas and Civil Investigative Demands**

For criminal investigative purposes, documents may be obtained under either an Inspector General (IG) or a grand jury subpoena. The civil investigative equivalent of a

grand jury subpoena is referred to as a civil investigative demand (CID). DCAA subpoenas will not be used in connection with investigations. When an investigative office obtains documents under an IG subpoena, it is the custodian of the documents. When the documents are obtained under a grand jury subpoena, the grand jury is the custodian and the government prosecutor or the investigator acts as the grand jury's agent or representative. Similar custodial requirements exist for CIDs. Requirements for safeguarding grand jury materials or CIDs are more stringent than for IG subpoenas.

a. Auditor responsibility for safeguarding contractor records is discussed in 1-507. The auditor is not relieved of responsibility simply because the records in question have been obtained under subpoena or because the contractor itself should be excluded from access to the subpoenaed records. When auditors are assigned to assist an investigation, they should be aware of their responsibility to exercise due care and be mindful that removal of original documents from the designated workplace could result in both significant embarrassment to the Agency and penalties to the auditor.

b. If an auditor is to work directly with an investigator or trial attorney, the acknowledgment of the request for audit services should state that, while the auditor will exercise due professional care, neither the auditor nor the Agency can assume responsibility for the completeness of subpoenaed documents that are not inventoried upon receipt and maintained under appropriate security thereafter.

c. If unsatisfactory conditions are encountered, the cognizant manager or supervisor should advise the head of the investigative agency of the situation in writing. The matter should then be left to the discretion of the investigative office. It is highly unlikely that security problems will arise under a grand jury subpoena; however, in that case, notice of unsatisfactory conditions should be furnished to the trial attorney with a copy to the investigator.

#### **4-702.8 Audit Reports Involving Alleged Subcontractor Fraud**

a. Most fraud statutes provide for measurement of total cost impact to the

government for damages resulting from subcontractor fraud or false statements. For example, a second-tier subcontractor may make a false statement to a first-tier subcontractor resulting in a \$1 million defective pricing. If the first-tier subcontractor and the prime contractor rely on the defective data, the impact to the government would exceed \$1 million after adding the two additional levels of overhead, G&A, and profit. In this example, the second-tier subcontractor would be liable for the entire cost impact to the government (plus penalties) even though its gain was only \$1 million. This situation differs significantly from a non-fraudulent defective pricing case where the government would seek recovery of the entire cost impact from the prime contractor. In non-fraudulent subcontractor defective pricing cases, the audit report procedures described in 10-602b. apply (i.e., subcontract audit reports are provided to the prime contract auditor who issues a consolidated report to the procurement authority).

b. In subcontract fraud matters, auditors at subcontractor locations are usually requested by investigators or attorneys to determine the total cost impact to the government. In such cases, the auditor supporting the investigation of the subcontractor should assume full responsibility for coordinating all audit activity necessary to respond to the request. Accordingly, the subcontractor investigative support auditor should request audit assistance from FAOs with audit cognizance over any higher-tier contractors and incorporate the results into a single consolidated report or memorandum to the requester. Use this procedure regardless of the number of higher-tier contractors. As part of this process, the subcontractor investigative support auditor should identify information needed from the higher-tier locations and supply the higher-tier auditors with any data necessary to assist them in their work. In acknowledging the request from the investigators or attorneys, the cognizant investigative support auditor should inform the requester of arrangements being made for the submission of reports on any (1) technical analysis or (2) evaluations of intracompany or higher-tier contractor additive factors.

c. Resolve any disputes between regions on administrative procedures or technical accounting matters that arise during assist audits in accordance with 6-807.

**4-703 Suspected Contractor Provision of Improper Gifts/Gratuities to Government Personnel**

a. The Standards of Ethical Conduct for the Executive branch (5 C.F.R. Part 2635, Subpart B) state that federal employees shall not accept gifts/gratuities directly or indirectly which are given because of the employee's official position or which are given to the employee by a prohibited source. "Direct or indirect acceptance" includes gifts to an employee's parent, sibling, spouse, child or dependent relative given because of the employee's relationship to that other person. "Prohibited sources" are any person or legal entity that:

- (1) seeks official action from the employee's agency;
- (2) does business or seeks to do business with the employee's agency;
- (3) conducts activities regulated by the employee's agency;
- (4) has interests that may be affected by the performance or nonperformance of the employee's duties; or
- (5) is an organization, a majority of whose members fall within any one or more of the prior four categories.

b. The Standards of Ethical Conduct for the Executive branch are found at Chapter 2 of DoD's Joint Ethics Regulation (JER), DoD 5500.7R. Additionally, 18 U.S.C. 203 makes it a crime for a government employee to receive compensation for his or her duties as a government employee from anyone other than the government. It also makes it a crime for someone to pay such compensation to a government employee.

c. A violation of 18 U.S.C. 203 or DoDD 5500.7 may become the subject of an investigation and can result in disciplinary action. DCAA auditors do not have a designated mission to monitor compliance with either the Standards of Ethical Conduct or the statute; consequently, audit programs do not contain specific steps to

detect noncompliance. However, any apparent noncompliance coming to your attention, regardless of the length of time since the suspected event occurred, is referable. Be aware, however, that there are exclusions from the definition of a gift and a number of listed exceptions to the gift prohibition including a blanket exception for gifts valued at less than \$20 per occasion and \$50 per calendar year. The exclusions and exceptions are found on pages 2-7 through 20-14 of Chapter 2 of the JER. A regulatory change [August 20, 1996] by the Office of Government Ethics provides greater authority for Federal agency ethics officials to permit the gift of free attendance to a "widely attended gathering" to be accepted by a Federal official when there is agency interest in that employee's participation in the event [e.g. a conference, dinner, reception, etc.] Therefore, be sure to evaluate these exceptions before making a referral. Guidance on the "widely attended gatherings" exception can be obtained from the DCAA General Counsel's office pending inclusion of that guidance in a revised or republished JER available in the field. Forward suspected offers or acceptances of gratuities even though no recipient can be identified or no investigative lead is apparent. The requirements for referral of personnel from other Federal agencies who have accepted gifts, gratuities, loans, favors, or entertainment are the same as those for DoD employees (see 4-704).

(1) The referral (DCAAF 2000 may be used) must contain as much information as is available. Such information includes the identity of the offeror and recipient (names, position titles, and agency/department or contractor), type of gratuity, range in dollar value of the gratuity or benefit detected, estimated total dollar value, the records reviewed, whether access to any records was denied, and why the auditor suspects that a gratuity was offered or received. Also, state whether the contractor is aware of the condition and, if so, include comments on the nature of corrective action taken or contemplated, including the adequacy of any repayments to the government.

(2) Do not forward with the referral many copies of essentially duplicative



documents from the contractor's records, such as expense vouchers. Instead, forward one or two representative samples of such records along with a listing of pertinent information such as names, dates, and amounts extracted from the records. All copies should be legible. If it is not possible to obtain a legible copy, state this fact in the referral and briefly describe the document.

(3) Send the referral to Headquarters, ATTN: OTS, with copies to the regional director. OTS will review the referral for possible forwarding to the appropriate investigative agency.

#### **4-704 Suspected Violations of the Anti-Kickback Act (41 U.S.C. 51 to 58)**

##### **4-704.1 General**

a. The Anti-Kickback Act (4-751) prohibits providing, attempting to provide, or offering to provide any kickback; soliciting, accepting, or attempting to accept any kickback; or including, directly or indirectly, any kickback in the contract price charged by a subcontractor to a prime contractor or a higher-tier subcontractor or in the contract price charged by a prime contractor to the government.

b. Kickback is defined as any money, fee, commission, credit, gift, gratuity, thing of value, or compensation of any kind which is provided, directly or indirectly, to any prime contractor, prime contractor employee, subcontractor, or subcontractor employee for the purpose of improperly obtaining or rewarding favorable treatment in connection with a prime contract or in connection with a subcontract relating to a prime contract.

##### **4-704.2 Examples of Questionable Practices**

Questionable practices under the Anti-Kickback Act may take such form as: payments of commissions to prime contractor personnel; entertainment provided for prime contractor personnel; loans to prime or higher-tier contractor personnel that may not be repaid and may be later recorded as an expense on the subcontractor's records;

and expensive gifts or preferential treatment to particular subcontractors.

##### **4-704.3 Audit Responsibilities**

Ascertain that contractors have informed (1) their personnel who award or administer subcontracts or purchase orders and (2) their subcontractors and suppliers about the provisions of the amended Anti-Kickback Act and questionable practices thereunder. If such action has not been taken by a contractor, recommend that the contracting officer require such action. In addition, cooperate to the extent necessary to ensure that the contractor's procurement personnel are aware of the provisions of the Act.

##### **4-704.4 Referral Requirements**

Because Public Law 99-634, "Anti-Kickback Enforcement Act of 1986," imposes a duty on the contractor to promptly report the possible violation in writing to the Inspector General of the contracting agency, to the head of the contracting agency if the agency does not have an Inspector General, or to the Department of Justice, the contractor has a statutorily imposed duty to self-report. Therefore, suspected kickbacks are ineligible for inclusion in the Voluntary Disclosure Program. When there is reason to believe that a violation of the Act has occurred, and the cognizant Defense criminal investigative organization has not been notified, the auditor shall promptly prepare a DCAA Form 2000. The Form 2000 will state all known details of the transaction. Coordinate and forward the Form 2000 in the same manner as those on suspected fraud (see 4-702.4).

#### **4-705 Suspected Anticompetitive Procurement Practices**

a. Anticompetitive procurement practices are those designed to eliminate competition or restrain trade. They include those practices or events listed in FAR 3.303(c). They do not include bona fide sole-source procurement actions, violations of the Competition in Contracting Act by

the procuring activity, or buying-in by a contractor.

b. If information received from any source indicates suspected anticompetitive procurement practices by a contractor or subcontractor, determine, by appropriate audit techniques, whether sufficient evidence exists to indicate an improper practice. If the anticompetitive procurement practice involves exclusive teaming arrangements, see 4-705c. For all other anticompetitive procurement practices, promptly submit a referral using the procedures set forth in 4-702.4.

c. When auditing a contractor's records, auditors may encounter, or receive from other sources, information constituting evidence or causing suspicion of an anticompetitive exclusive teaming arrangement. Because of the complexity of antitrust laws, the existence of an exclusive teaming arrangement does not necessarily mean an anticompetitive situation exists. An example of an anticompetitive exclusive teaming arrangement is when one company teams exclusively with another company which other potential offerors consider essential for contract performance. The potential for an antitrust violation is present only if one or a combination of the companies participating in an exclusive teaming arrangement is the sole provider of a product or service that is essential for contract performance, and the government's efforts to eliminate the exclusive teaming arrangement are unsuccessful. Therefore, if the information received from any source indicates an anticompetitive exclusive teaming arrangement, the auditor should promptly notify the contracting officer. If the auditor believes the contracting officer's efforts to resolve an anticompetitive exclusive teaming arrangement are not successful, the auditor will consult with DCAA Headquarters General Counsel for further guidance.

#### **4-706 Suspected Illegal Political Contributions**

##### **4-706.1 The Statute**

a. Title 2 U.S.C. 441c, in essence, prohibits any firm or person contracting

with the United States from making a contribution to or expenditure for a political party, committee, candidate for public office, or any person, for a political purpose or use. The statute applies only at the national level, not the state and local levels.

b. The term "contribution" includes: (1) any gift, subscription, loan, advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office; or (2) the payment by any person of compensation for the personal services of another person which are given to a political committee without charge for any purpose.

##### **4-706.2 Methods of Channeling Inappropriate Expenditures**

Corporations that make illegal political contributions may use several means to channel such payments to the intended recipient. Be alert to such methods as:

a. Bonus payments to contractor personnel passed on by the employee as a personal contribution or returned to the company to make the contribution. These payments usually cover taxes paid by the employee. Review carefully any bonus payments which might be based on a formula designed to cover taxes due.

b. Payments to outside consultants or other professional contacts. Such payments may be too high for the service received or there may be no services received at all. Scrutinize high or unusual professional and consultant service expenses for inappropriate expenditures. Such scrutiny involves a comprehensive review of supporting documentation, which should state the extent of services provided.

c. Padding or falsifying expenses paid to employees. Such expenses may include travel, dues, memberships and subscriptions, training, educational expenses, or any expenses where the contractor makes payment based on an invoice from an employee or a close, outside associate.

##### **4-706.3 Audit Responsibilities**

It would be impractical to perform the audit effort necessary to disclose every illegal political contribution. However,

government auditing standards require auditors to design audit steps and procedures to provide reasonable assurance of detecting errors, irregularities, abuse, illegal acts, or other unlawful activity that could significantly affect the audit objectives or results of audit (see 4-702.2a).

#### **4-706.4 Referral Requirements**

When a violation of the statute is suspected, submit a report describing all known details of the transaction to Headquarters, ATTN: OTS, for possible referral to the Federal Election Commission. The DCAAF 2000 may be used for this purpose. "Early alerts" are not required when reporting this suspected misconduct.

#### **4-707 Voluntary Disclosure Program**

##### **4-707.1 General**

a. The Department of Defense encourages contractors to adopt, as a central part of corporate self-governance, a policy of voluntarily disclosing problems affecting their contractual relationship with the DoD. The program is intended to be mutually advantageous to both the government and contractors. Such advantages include:

- (1) increased likelihood of the government recouping losses of which it might otherwise be unaware;
- (2) reduction in the work required by the government to investigate the problem;
- (3) relaxation of adversarial tensions between the government and contractors, thus expediting consideration of remedies by the DoD and the DOJ;
- (4) positive indications of contractor integrity by their disclosure and cooperation; and
- (5) increased likelihood of self-initiated corrective actions by contractors.

b. In return for voluntarily disclosing potential fraud and agreeing to cooperate in any government audit and investigation, the government will generally allow a contractor to conduct an internal investigation which the government will attempt to verify in an expedited manner. DoD will also generally agree not to initiate suspension or debarment action until this verification process is completed. Determinations re-

garding suspension and debarment will consider the contractor's achievements in ensuring corporate integrity. Prompt voluntary disclosure, full cooperation, complete access to contractor records, restitution, and adequate corrective actions are considered key indicators of contractor integrity.

c. To be accepted into the DoD Voluntary Disclosure Program:

(1) the disclosure must not be triggered by the contractor's recognition that the underlying facts are about to be discovered by the government through audit, investigation, or contract administration efforts, or reported to the government by third parties;

(2) the disclosure must be on behalf of the business entity, in contrast to admissions by individual officials or employees;

(3) prompt and complete corrective action, including disciplinary action and restitution to the government when appropriate, must be taken by the contractor in response to the matters disclosed; and

(4) after disclosure, the contractor must cooperate fully with the government in any ensuing investigation or audit.

If suspected irregularities are found during a joint audit as described in 4-202.1d, the contractor will have 30 days to make a voluntary disclosure (see 4-702.2d).

d. The Assistant Inspector General for Investigations, Office of Criminal Policy and Oversight, (AIG(CIPO)) serves as the focal point for the dissemination of general information concerning the Voluntary Disclosure Program, administers the program, and coordinates administrative action within DoD. Inform defense contractors wishing to make a disclosure of potential fraud as part of the Voluntary Disclosure Program to contact the Voluntary Disclosure Program Manager at telephone number (703) 604-8711. Matters not involving potential criminal or civil fraud, i.e., those that are contractual or administrative in nature, may be reported to the cognizant contracting officer or DCAA office.

e. One defense criminal investigative organization (DCIO) will serve as the lead investigative agency to verify the accuracy and completeness of the matter(s) disclosed. In most instances, the lead DCIO will request DCAA to conduct an audit or provide some type of audit assistance. The DCAA auditor assigned will be briefed on

the DCIO investigative plan to ensure a coordinated effort. If enough information is available and the circumstances warrant, the DCIO may begin its investigation before completion or in conjunction with the audit.

#### **4-707.2 Audit Responsibility – Voluntary Disclosure**

a. Regardless of the type of audit activity involved, treat requests for DCAA assistance related to voluntary disclosures as demand assignments and schedule them for completion on that basis. (See 4-702.6 for the procedures to follow when responding to such requests.) Prompt completion is usually critical to a criminal or civil investigation. Accordingly, inform requesters immediately of any anticipated delays in the performance of the audit.

b. The scope of the audit will focus on the matters disclosed by the contractor and include a quantification of the government loss. Unrelated fraud allegations developed during the verification process are to be pursued by the initiation of an independent audit or investigation using normal procedures (see 4-702.4) unless the relationship to the matter disclosed is so commingled as to prevent their severance. Do not treat such additional allegations as part of the Voluntary Disclosure Program without prior coordination with the lead DCIO.

c. Contractor cooperation is essential to the audit. When contractor cooperation is unsatisfactory, promptly notify the lead DCIO. It is the responsibility of the DCIO to ensure access to information required for the verification audit.

d. Situations may occur in which a contractor or its legal counsel attempts to make a voluntary disclosure of potential civil or criminal fraud directly to DCAA. If this happens, the FAO should:

(1) Determine if the disclosure has any immediate impact on costs charged to government contracts that would warrant suspension or disallowance of costs. If yes, bring the matter to the attention of Headquarters (OTS), through the regional office, before suspensions or disallowances are made.

(2) Inform the ACO of the disclosure, if he or she is not already aware.

(3) Determine if the contractor has made or intends to make a disclosure under the Voluntary Disclosure Program. If yes, direct them to contact the Voluntary Disclosure Program Manager if they have not done so already (see 4-707.1d.) and allow the contractor to proceed with its own investigation without initiating a parallel audit. Confirm, however, that the contractor has made the formal disclosure.

(4) If the contractor does not make a formal disclosure, evaluate the situation using the guidance in 4-702. The FAO or region should consult with Headquarters (OTS) before submitting a DCAAF 2000.

(5) Immediately forward any documentation concerning an attempted voluntary disclosure to Headquarters (OTS).

e. Under no circumstances (fraud or no fraud) are DCAA personnel to accept refund checks.

f. On occasion a contracting officer who has received a voluntary disclosure may request DCAA assistance. In such cases, follow the procedures in paragraphs a - e above. If you are aware of a voluntary disclosure made to a contracting officer, provide Headquarters (OTS) a narrative report on the incident, accompanied by all pertinent documentation. Do not follow the procedures in 4-702.4.

#### **4-707.3 Audit Reports**

a. Audit reports will be addressed to the DCIO requesting the audit. In addition, a copy will normally be furnished to the ACO, affected PCOs, and the DCAA Justice Liaison Auditor (see 4-702.5b.). If the requester asks that distribution of the report be limited, refer the matter to Headquarters (OTS) through the Region.

b. Audit of a voluntary disclosure is to be performed in accordance with the guidance covering the matter(s) disclosed, and the auditor should identify and review similar transactions to confirm that the disclosure was complete. For example, a disclosure of defective pricing should be evaluated in accordance with 14-100, and the defective pricing potential of contracts awarded under circumstances similar to those affected by the disclosed irregularity should be evaluated. If the irregularity affects a subcontract, include the impact of

prime contractor additives as discussed in 4-702.8. Since the contractor is required to provide data supporting its findings and computations, procedures applicable to audits of voluntary disclosures are not considered to be investigative in nature, and the restrictions in 4-702.5 and 4-702.6 do not apply. To the extent possible, tests of transactions and other routine audit procedures performed during evaluations of voluntary disclosures should be incorporated in the ongoing workload to satisfy requirements of the affected audit area.

c. Prepare audit reports using the format in 10-1200. However, be certain all relevant issues are covered. Do not hesitate to expand the report format in the interest of clarity.

d. Do not release results of audit, including draft condition statements or recommendations, to the contractor before consulting with and obtaining the approval of the DCIO. Discuss factual matters with the contractor only to the extent necessary to ensure accuracy. These procedures are necessary to prevent premature release of audit results which could compromise government actions regarding the condition under investigation.

#### **4-708 Obstruction of Audit**

a. The Anti-Drug Abuse Act of 1988 (P.L. 100-690) added section 1516 to Title 18, U.S.C., which contains an obstruction of audit provision. This provision makes it a crime for a person or corporation to endeavor to influence, obstruct, or impede, with the intent to deceive or defraud the government, a Federal auditor in the performance of official duties. The purpose of the provision is to punish acts designed to prevent an auditor from discovering or reporting fraud or deceit against the government. The provision does not make it a crime to deny an auditor access to records unless the purpose of the denial is to prevent such discovery. Therefore, do not report a suspicion of fraud or other unlawful activity solely on the basis that access to records was denied. Pursue access to records problems in accordance with 1-504.5.

b. If there is a reasonable basis to suspect fraud or deceit against the government, and you believe a denial of access

to records is an attempt to prevent an auditor from discovering or reporting this fraud or deceit, include this information in a suspected fraud referral (see 4-702.4). The mere denial of access to records, however, is not by itself a reasonable basis to suspect fraud.

c. When reporting suspicions of fraud or other unlawful activity (see 4-702.4), include any information on suspected contractor efforts to influence, obstruct, or impede an auditor with the intent to deceive or defraud the government.

#### **4-709 Qui Tam Actions Under the False Claims Act**

Qui tam actions are civil, not criminal, actions, which are brought under the authority of the False Claims Act. In such a suit, the plaintiff brings the action on behalf of the government. A qui tam suit is filed under seal. The defendant contractor is not provided with a copy of the filing nor is it to be told the contents of the filing while the action is under seal. The government is furnished a copy of the filing and has 60 days in which to make a decision on whether it will join in the suit. To assist its deliberations, the DOJ will frequently seek information about the defendant contractor from DCAA. Information in our files and working papers is to be made readily available to the attorney handling the case as well as any DoD personnel supporting the attorney. Any requests for additional audit support will be treated as a demand assignment. The contractor is not to be informed of the source of these requests without the approval of the requesting attorney. At the same time, the FAO should determine if the attorney has any objections to providing the results of the audit to the contracting officer. If there are none, a report should be sent to the contracting officer. However, the report will caution that the audit was conducted in connection with a qui tam suit and that before any contractual action is taken on the matter, permission must be obtained from the responsible attorney.

#### **4-710 Defense Hotline**

a. The Defense Hotline is an element of the DoD Inspector General Office of Inves-

tigations which receives and reviews audit and investigative leads. The Defense Hotline operates to ensure that allegations of fraud and mismanagement are properly evaluated, substantive allegations are examined, appropriate administrative, remedial or prosecutive actions are taken and administrative procedures are in place and maintained in order to properly manage Hotline allegations. It receives allegations from government entities such as DoD, from private individuals both inside and outside the government, and from the GAO. The Hotline assigns review of these leads to the audit or investigative agency it believes is best qualified to determine their validity; monitors the progress of the examination; reviews and analyzes all interim and final reports to determine that the examinations are conducted properly and the appropriate corrective measures were recommended and/or taken; and tabulates and reports case dispositions. DoD instructions pertaining to the Defense Hotline program are discussed in DoDD 7050.1. DCAA responsibilities for reviewing Hotline referrals are set out in DCAAR 7600.1.

b. In accordance with DoD IG Joint Policy Memorandum Number 95-2 dated May 26, 1995, the DoD Hotline reviews will only be performed by individuals and organizations who are independent. Accordingly, non-government employees and/or organizations, including contractor internal audit groups or external auditors, will not perform any work in relation to any DoD Hotline review because of their inherent lack of independence.

c. The Hotline and the Agency are obligated to protect the anonymity of sources. The Headquarters, DCAA transmittal of a sensitive Hotline referral will make specific reference to nondisclosure requirements in its opening paragraph. Hotline documents arising from such a source are clearly marked. In order to evaluate a Hotline referral, it may be necessary to advise a contractor that an audit lead has been received. However, the auditor should strive to reveal only the minimum amount of information necessary to conduct a proper and thorough review. The Hotline should not be identified as the source of the lead. Under no circumstances may Hot-

line documents be released outside the government. Hotline documents may be released within government channels only to agencies/employees involved in the Hotline review.

d. At its discretion, the Hotline may determine that an allegation lacks significant detail or significant subject matter to warrant formal inquiry. Such a matter will be classified as an information referral. All other referrals are action referrals which are assigned a due date. Hotline referrals are reviewed in Headquarters, OTS, and are forwarded to the cognizant regional office for information or response. The regional office may further delegate responsibility. Delegation of the decision to conduct a field review of an information referral does not convert the status of that referral to an action referral. However, if a field audit is undertaken, results must be reported to the Hotline.

e. All Hotline referrals which have been assigned due dates, either by the Hotline or by Headquarters, are to be treated as demand assignments. If a due date cannot be met, an extension should be requested by filing a Hotline Progress Report (DCAAR 7600.1). The Hotline has suggested that six month extension requests reduce unnecessary proliferation of progress reports. It is the responsibility of the Regional Office to assure that Hotline progress and completion reports are issued in the specified format.

f. When a field audit of a Hotline referral involving alleged fraud is undertaken, allegations are to be treated as audit leads and followed up through audit in accordance with 4-702.2c. If a reasonable suspension of fraud or other unlawful activity remains after performing the appropriate risk assessment and audit steps, arrangements should be made for transfer of the matter to an investigative agency. The responsible field element should discuss the case with the investigative office to which it would have sent a DCAAF 2000 had the allegation arisen through audit. (However, matters first reported through the Defense Hotline are deemed to be known to the government, and therefore ineligible for reporting on the DCAAF 2000.) Case responsibility may be transferred by submitting a Hotline Completion Report (DCAAR 7600.1) to

Headquarters, Attention OTS, setting out the results of audit, the reason(s) for transfer, and the investigative office to which the matter should be transferred.

g. Audit procedures and reporting following transfer of a Hotline referral to an investigative agency should be carried out in accord with 4-702.5. If a transfer is not made, audit findings should be pursued and reported in accord with normal procedures. If available, audit reports containing findings and recommendations which arose from a Hotline referral should be submitted as an enclosure to the Hotline Completion Report.

h. When a referral makes allegations of a technical nature, the assistance of a government technical evaluator should be obtained. Occasionally it becomes apparent that the technical evaluator's agency should assume responsibility for the referral, with audit support as needed. When this happens, transfer of responsibility should be formalized similarly to investigative transfer.

#### **4-711 Evaluating Contractor Compliance with Administrative Suspension and Debarment Agreements**

a. Background. Contractors found to have committed fraud or other misconduct sometimes enter into suspension and debarment agreements to avoid being suspended or debarred from obtaining government contract awards or to be removed from the listing of suspended or debarred companies. These agreements usually require the contractor to implement ethics and fraud prevention programs and strengthen internal controls over the areas where the fraud or other misconduct occurred. Often, the agreements require the contractor to maintain a Hotline for employees to report fraud or other irregularities. Sometimes the costs incurred by the contractor to comply with these agreements are unallowable under FAR 31.205-47. Each Service and the Defense Logistics Agency has suspension and debarment officials or designees who are responsible for monitoring contractor compliance with the agreements.

b. Responsibilities. The suspension and debarment officials or designees will

request DCAA audit support to evaluate contractor compliance with any provisions of the agreement that relate to DCAA's audit mission. For example, the auditor will generally be requested to perform an audit if the contractor is identifying and segregating the unallowable costs being incurred to comply with the agreement. If the agreement also provides for the contractor to make improvements to its internal control systems, the auditor will generally be requested to determine if the improvements have been made. The suspension and debarment officials or designees are responsible for assessing overall contractor compliance with the agreement.

c. Briefing of the Agreement and Coordination. At those contractors with suspension and debarment agreements, the FAO should obtain a copy and brief the agreement to identify provisions that fall within DCAA's areas of responsibility. The FAO should then discuss with the responsible suspension and debarment official or designee and the contracting officer the audit services needed to assist in evaluating contractor compliance. Any differences of opinion between the FAO and the suspension and debarment official or designee or any difficulty in arranging a meeting should be communicated through the Regional Office to PAS for resolution. The results of this coordination should be documented in the FAO's audit planning files.

d. Audit Planning. The FAO normally will not have to establish special audits to provide the needed audit support. The audit steps needed to assist the suspension or debarment official or designee in determining compliance with the provisions of the agreement can be usually performed as part of the FAO's regularly scheduled audits; e.g., the FAO's planned audits of internal controls relating to the identification and segregation of unallowable costs. However, if the compliance officer requests a special audit because of his scheduled responsibilities, the FAO should provide the requested services.

e. Corporate Offices. Settlements at the corporate level affecting two or more segments should be coordinated by the corporate auditor or CAC. After the briefing, the

corporate auditor or CAC will disseminate the agreement to the segment auditors with an assist audit request (if applicable) on any services needed to assess compliance with the relevant parts of the agreement.

f. Reporting. The FAO should communicate in writing all noncompliances or other concerns with the agreement to the ACO cognizant of the contractor with a copy to the suspension and debarring official or designee. All applicable DCAA audit reports should contain comments on

any contractor actions required by a suspension/debarment agreement until the contractor fully implements or complies with the agreement.

g. Semiannual Updates. On a semiannual basis, PAS will obtain listings of the contractors currently under suspension and debarment agreements and provide them to the regional offices for distribution to the appropriate FAOs. A debarred bidders list is also available at <http://epls.arnet.gov>.



**4-7S1 Supplement - Public Law 99-634, "Anti-Kickback Enforcement Act of 1986"**

An Act to prohibit kickbacks relating to subcontracts under Federal government contracts.

Section 1. This Act may be cited as the "Anti-Kickback Act of 1986."

Section 2. As used in this Act:

(1) The term "contracting agency," when used with respect to a prime contractor, means any department, agency, or establishment of the United States which enters into a prime contract with a prime contractor.

(2) The term "kickback" means any money, fee, commission, credit, gift, gratuity, thing of value, or compensation of any kind which is provided, directly or indirectly, to any prime contractor, prime contractor employee, subcontractor, or subcontractor employee for the purpose of improperly obtaining or rewarding favorable treatment in connection with a prime contract or in connection with a subcontract relating to a prime contract.

(3) The term "person" means a corporation, partnership, business association of any kind, trust, joint-stock company, or individual.

(4) The term "prime contract" means a contract or contractual action entered into by the United States for the purpose of obtaining supplies, materials, equipment, or services of any kind.

(5) The term "prime contractor" means a person who has entered into a prime contract with the United States.

(6) The term "prime contractor employee" means any officer, partner, employee, or agent of a prime contractor.

(7) The term "subcontract" means a contract or contractual action entered into by a prime contractor or subcontractor for the purpose of obtaining supplies, materials, equipment, or services of any kind under a prime contract.

(8) The term "subcontractor"

(A) means any person, other than the prime contractor, who offers to furnish or furnishes any supplies, materials, equipment, or services of any kind under a prime contract or a subcontract entered into in connection with such prime contract; and

(B) includes any person who offers to furnish or furnishes general supplies to

the prime contractor or a higher tier subcontractor.

(9) The term "subcontractor employee" means any officer, partner, employee, or agent of a subcontractor.

Section 3. It is prohibited for any person ---

(1) to provide, attempt to provide, or offer to provide any kickback;

(2) to solicit, accept, or attempt to accept any kickback; or

(3) to include, directly or indirectly, the amount of any kickback prohibited by clause (1) or (2) in the contract price charged by a subcontractor to a prime contractor or a higher tier subcontractor or in the contract price charged by a prime contractor to the United States.

Section 4. Any person who knowingly and willfully engages in conduct prohibited by section 3 shall be imprisoned for not more than 10 years or shall be subject to a fine in accordance with title 18, United States Code, or both.

Section 5. (a).

(1) The United States may, in a civil action, recover a civil penalty from any person who knowingly engages in conduct prohibited by section 3. The amount of such civil penalty shall be --

(A) twice the amount of each kickback involved in the violation; and

(B) not more than \$10,000 for each occurrence of prohibited conduct.

(2) The United States may, in a civil action, recover a civil penalty from any person whose employee, subcontractor or subcontractor employee violates section 3 by providing, accepting or charging a kickback. The amount of such civil penalty shall be the amount of that kickback.

(b) A civil action under this section shall be barred unless the action is commenced within 6 years after the later of (1) the date on which the prohibited conduct establishing the cause of action occurred, and (2) the date on which the United States first knew or should reasonably have known that the prohibited conduct had occurred.

Section 6. (a) A contracting officer of a contracting agency may offset the amount

of a kickback provided, accepted, or charged in violation of section 3 against any moneys owed by the United States to the prime contractor under the prime contract to which such kickback relates.

(b)(1) Upon direction of a contracting officer of a contracting agency with respect to a prime contract, the prime contractor shall withhold from any sums owed to a subcontractor under a subcontract of the prime contract the amount of any kickback which was or may be offset against that prime contractor under subsection (a).

(2) Such contracting officer may order that sums withheld under paragraph (1) -

(A) be paid over to the contracting agency; or

(B) if the United States has already offset the amount of such sums against that prime contractor, be retained by the prime contractor.

(3) The prime contractor shall notify the contracting officer when an amount is withheld and retained under paragraph (2)(B).

(c) An offset under subsection (a) or a direction or order of a contracting officer under subsection (b) is a claim by the government for the purposes of the Contract Disputes Act of 1978.

(d) As used in this section, the term "contracting officer" has the meaning given that term for the purposes of the Contract Disputes Act of 1978.

Section 7. (a) Each contracting agency shall include in each prime contract awarded by such agency a requirement that the prime contractor shall have in place and follow reasonable procedures designed to prevent and detect violations of section 3 in its own operations and direct business relationships.

(b) Each contracting agency shall include in each prime contract awarded by such agency a requirement that the prime contractor shall cooperate fully with any Federal government agency investigating a violation of section 3.

(c)(1)(A) Whenever a prime contractor or subcontractor has reasonable grounds to believe that a violation of section 3 may have occurred, the prime contractor or subcontractor shall promptly report the possible violation in writing.

(B) A contractor shall make the reports required by subparagraph (A) to the inspector general of the contracting agency, the head of the contracting agency if the agency does not have an inspector general, or the Department of Justice.

(2) In the case of an administrative or contractual action to suspend or debar any person who is eligible to enter into contracts with the Federal government, evidence that such person has supplied information to the United States pursuant to paragraph (1) shall be favorable evidence of such person's responsibility for the purposes of Federal procurement laws and regulations.

Section 8. For the purpose of ascertaining whether there has been a violation of section 3 with respect to any prime contract, the General Accounting Office and the inspector general of the contracting agency, or a representative of such contracting agency designated by the head of such agency if the agency does not have an inspector general, shall have access to and may inspect the facilities and audit the books and records, including any electronic data or records, of any prime contractor or subcontractor under a prime contract awarded by such agency.

January 2003

461  
Figure 4-7-1

**Figure 4-7-1**  
**Pro Forma Cautionary Transmittal Memorandum**

FOR OFFICIAL USE ONLY

MEMORANDUM FOR (name and address of requestor)

SUBJECT: Cautionary Statement Related to Audit Report (audit report number, date and subject, and the contractor's name and location)

The attached audit report addresses certain matters which have raised a suspicion of potential fraud on the part of (indicate the name of the company involved). Specifically, those matters are (describe the suspected fraudulent conduct). We are willing to discuss these matters with you, your counsel, and representatives of the cognizant criminal investigative organization in an effort to reach a proper disposition of these issues in light of the requirements of DoD Directive 7050.5, Coordination of Remedies for Fraud and Corruption Related to Procurement Activities.

(Signature)  
Branch Manager

FOR OFFICIAL USE ONLY

**Figure 4-7-2  
Suspected Irregularity Referral Form**

**(Use full size form or DIIS Version for reporting)**

**DCAA CASE NO.:** \_\_\_\_\_

***SUSPECTED IRREGULARITY REFERRAL FORM***

Follow enclosed guidance and DCAA Instruction 7640.16 when providing the following information:

1. Name, FAO, RORG number, telephone and FAX numbers, and e-mail address of the auditor preparing the referral.
2. Contractor's name, division, and address. Identify if the contractor is a small/disadvantaged (8a) firm.
3. Government entities (e.g. Navy, DOE, HHS, etc.) affected by irregularity. If possible, identify contract(s), types, amounts, and major program(s) affected.
4. Classification of irregularity (See the enclosed instructions)
5. Prepare, on a separate page, a concise description of the irregularity. Include the following criteria: **who, what, where, when, how, how much**. If possible, identify regulatory provisions and/or statutes violated. Attach documentation (appropriately cross-referenced) as necessary.
6. Reason for treating this as other than normal questioned costs (e.g.; if suspected fraud, where is the **material statement**, which is **false**, and why do you think it is **known** by the maker to be false?)
7. Estimated loss or impact to the Government. Explain basis and any reasons for limited current visibility of total losses.
8. Signature of Auditor and FAO Manager and date (must be signed and dated).

\_\_\_\_\_  
Auditor

\_\_\_\_\_  
Date

\_\_\_\_\_  
Branch Manager/Resident Auditor

\_\_\_\_\_  
Date

9. Distribution: Headquarters OTS, ACO/PCO, and Cognizant Investigator  
(See Appendix 1 of DCAAI 7640.16). Identify all addressees.

DCAAF 2000  
February 1998

**INSTRUCTIONS FOR PREPARATION OF FORM 2000****GENERAL:**

Information which suggests a reasonable basis for suspicion of fraud, corruption, or unlawful activity affecting Government contracts must be reported **promptly**. For reporting purposes, **fraud** is defined as: a **material statement** of fact which is **false**, and **known** to be false. Other reportable irregularities include Kickbacks, Gratuities, Illegal Political Contributions, Foreign Corrupt Practices Act violations, and Agreements in Restraint of Trade. Activities **not** reportable on the Form 2000 include matters such as (1) those already known by the Government, (2) Voluntary Disclosures, and (3) unsatisfactory conditions (CAM 4-800).

An effective referral requires close communication between auditors, supervisors and FAO Managers. It is suggested that you also coordinate with your Regional Investigative Support Division (RSI) if there are any questions about whether or not to refer the matter, keeping in mind the need for **promptness**. Follow instructions in CAM 4-700 and DCAAI 7640.16 in preparing the Form. Use continuation pages as necessary, especially for question 5, keeping in mind the need for **conciseness**. Signature by the FAO Manager denotes that appropriate audit was accomplished and he or she agrees that the information presented raises a reasonable suspicion of fraud, corruption, or other unlawful activity.

**Classification of Irregularity (Form 2000, Item 4):**

To assist the investigator in evaluation of the material presented, indicate in item 4 which of the following classifications best fits the matter being referred (more than 1 classification may apply):

1. Defective Pricing a. Pattern of Activity b. Other (explain)	5. False Claims/Certifications a. Equitable Adjust. Claims b. Termination Settlements c. Indirect Cost Certification d. Other (explain)	8. Ethical Violations a. Kickbacks b. Gratuities c. Political Contributions d. Foreign Corrupt Practices Act e. Bribery f. Restraint of Trade g. Other (explain)
2. Billing Irregularities a. Progress Payments b. Public vouchers c. Other (explain)	6. Consultants/Subcontractors a. Consulting Irregularities b. Subcontract Irregularities	
3. Labor Irregularities a. Timekeeping b. IR&D/B&P Mischarges c. Other (explain)	7. Materials a. Product Substitution b. MMAS c. Other (explain)	9. Other Irregular Activity a. Conspiracy b. Obstruction of Audit (see CAM 4-708) c. Other (explain)
4. Accounting Mischarging a. FAR 31/CAS 405 Violations b. Improper Transfers c. Unallocable Costs d. Other (explain)		

DCAAF 2000  
February 1998

**Figure 4-7-3**  
**Examples of Characteristics and Types of Activity Associated with Illegal Expenditures and Acts for Specific Audit Areas**

<b>Audit Area</b>	<b>Indicators</b>
Labor	<p>Unexplained changes to timecards transferring hours from commercial firm-fixed-price contracts to government cost-type contracts.</p> <p>Employee time charged differently than associated travel costs.</p> <p>Diverting labor from firm-fixed-price contract by reclassifying employees as indirect who provide direct labor to firm-fixed-price contracts.</p>
Material	<p>Significant material requirements charged to government cost-type contracts where follow-up work shows that the material was not needed.</p> <p>Using inferior material on government contracts that does not meet contract specifications.</p> <p>False certification of inspection test results.</p>
Subcontracts	<p>Intercompany profit claimed and billed for an intercompany affiliate that the contractor represented to the government was an unrelated subcontractor.</p>
Indirect Cost	<p>Overrun contract costs charged to indirect expenses for allocation to other contracts.</p> <p>Expressly unallowable costs recorded in accounts that are generally allowable such as small tools and supplies.</p> <p>Improper transfers, or recording, of costs to indirect accounts for direct contract costs that are not allowed to be charged under the terms of the contract.</p>
Defective Pricing	<p>See 14-121.2 for listing.</p>
All Audit Areas	<p>Alterations to documents that would result in improper costs claimed for government contracts.</p> <p>Evidence showing that payments were not actually made for the amounts shown on the document.</p>

**4-800 Section 8 --- Special Reporting of Unsatisfactory Conditions****4-801 Introduction**

This section contains guidance and procedures on special reporting requirements on unsatisfactory conditions noted by contract auditors that are not reportable under section 7 of this chapter.

**4-802 Voluntary Refunds for "Windfall Profits"****4-802.1 Introduction**

DFARS Subpart 242.7100 expresses DoD policy and general procedures on the solicitation or acceptance of voluntary refunds from contractors or subcontractors.

**4-802.2 Audit Responsibility – Voluntary Refunds**

When the contract auditor reaches a conclusion pursuant to 4-802.3 that it may be appropriate to seek a voluntary refund, the auditor should observe DFARS Subpart 242.71 carefully, and inform the cognizant administrative contracting officer, in writing, of this conclusion and its basis, either in an audit report or otherwise.

**4-802.3 Audit Procedures**

On audits of any type, auditors should be alert to situations where the government was overcharged under a contract; was inadequately compensated for the use of government-owned property, or in the disposition of contractor inventory; and where the contractor's or subcontractor's retention of the amount in question would be contrary to good conscience and equity. If any of these situations are disclosed and it is due, at least in part, to the fault of the contractor or subcontractor, the government may request a voluntary refund or credit, provided the adjustment is not otherwise required by contractual terms or statutory requirements such as 10 U.S.C. 2306a.

**4-802.4 Audit Reports**

a. Prepare reports on situations involving voluntary refunds in a narrative format

pursuant to 10-1200. A decision to seek a voluntary price adjustment must be approved by the head of the contracting activity, or as provided in department/agency regulations. Therefore, the report or letter should contain sufficient information to permit adequate consideration of the facts and to support a decision at that level.

b. Address a report or letter involving a subcontractor to the contracting officer and forward it through the office which has audit cognizance of the prime contractor. Where audit cognizance has not been established for the prime contract and the prime contractor is not otherwise subject to audit by another audit office, transmit the report directly to the contracting officer in the same manner as if it involved a prime contract.

**4-803 Unsatisfactory Conditions (Serious Weaknesses, Mismanagement, Negligence, etc.) on the Part of Contractor or Government Personnel****4-803.1 Introduction**

a. Unsatisfactory conditions, such as repeated and significant deficiencies in accounting or estimating practices, mismanagement or negligence, and failure to comply with acquisition regulations may result in significant monetary loss or cost to the government, or frustrate public policy.

b. Unsatisfactory conditions are not to be reported on the DCAAF 2000. Denial of access to records (DCAAI 7640.17) is an unsatisfactory condition for which a specific remedy (the DCAA subpoena) is available. Neither suspected irregular conduct nor denial of access to records is reportable under this section.

**4-803.2 Examples of Questionable Practices**

a. Examples of unsatisfactory conditions in contractor operations include, but are not limited to, the following:

(1) An estimating system and related practices so deficient that price proposals are consistently unreliable, resulting in widespread defective pricing.

(2) Significant and chronic violations of Cost Accounting Standards.

(3) Internal control weaknesses of a magnitude that could cause significant monetary loss to the contractor and excessive cost to the government.

(4) Excessive or premature contractor reimbursement because of inappropriate application or review of economic price adjustment provisions.

(5) Failure to pay the minimum wages required by the Davis-Bacon Act, Walsh-Healey Public Contract Act, or the Service Contract Act.

b. Unsatisfactory conditions include situations where it appears that a government official has failed to comply with specific regulatory requirements or is grossly negligent in fulfilling his or her responsibility resulting in substantial harm to the government. Violations of criminal and penal statutory provisions such as those implemented by the Joint Ethics Regulation may be reported on the DCAAF 2000. DL should be consulted before such a referral is made. If a referral of this nature is made, the FAO should provide DL with an information copy when the formal copy is submitted to O.

#### 4-803.3 Audit Responsibilities

a. Serious weaknesses causing major audit problems encountered during audit performance should be discussed with the contractor, the principal cognizant ACO, and the CAC as soon as possible so as to expedite the resolution process. The auditor should not wait until the final exit conference or the issuance of the audit report to convey such findings. All such discussions should be documented by appropriate memorandums or notations in the working papers and a separate audit report issued using the procedures in 10-400, 10-800, or 10-1200.

b. When an unsatisfactory condition is called to the FAO manager's attention in writing, the FAO manager may:

- determine that no action is required;
- take appropriate action to resolve the condition; or
- determine that the condition cannot be resolved at the FAO level and request regional assistance.

The FAO manager should prepare a memorandum for record documenting judgments and conclusions supporting the choice of alternative. A copy should be furnished to the originator, with an information copy to the RAM, and the original report and the resulting MFR should be retained within an appropriate FAO file.

#### 4-803.4 Headquarters Reporting Requirements

a. Contractor operations.

(1) When an FAO encounters unsatisfactory conditions in contractor operations and the issue cannot be resolved at the FAO level, the FAO should involve the regional office promptly.

(2) If the condition is not or cannot be corrected after all FAO and regional office efforts have been exhausted, the regional office will prepare a Headquarters report describing the condition along with the actions taken to correct it and submit it to Headquarters, ATTN: P and DL. Before the report is submitted, the regional director will assure that it contains all pertinent facts, including the FAO's original report and a comprehensive explanation of all actions taken to resolve the matter. Wherever determinable, it should include the monetary amount involved.

b. Wrongdoing, Misconduct or Dereliction by Government Officials.

(1) The contracting officer has wide authority to make decisions regarding contract matters. DCAA auditors act as advisors to contracting officers. Simple disagreement between the audit position and the contracting officer's decision is not reportable as an unsatisfactory condition.

(2) Contract audit followup procedures (15-600) provide a further mechanism to monitor and ensure the proper and timely resolution and disposition of contract audit reports. Differences of opinion which will be resolved through these procedures should not be reported as unsatisfactory conditions.

(3) If the condition which results in significant harm to the government's interest cannot be corrected at the FAO level, regional assistance should be re-



quested. The FAO's request for assistance should be based on sufficient evidential matter, and should include written documentation of:

- attempt(s) to resolve the issue(s) locally;
- elevation of the situation and/or issues in question through the involved government official's own management channels; and
- details of alleged instances of clear and unmistakable noncompliance with specific regulatory requirements or alleged gross negligence.

Managers at all levels should assure that there is a common understanding of the purpose, approach, and probable results of such actions.

(4) If the issue cannot be corrected at the regional level, the regional office will prepare a Headquarters report describing the condition along with the actions taken to correct it and submit it to Headquarters, ATTN: P and DL. Before the report is submitted, the regional director will assure that it contains all pertinent facts, including the FAO's original report and a comprehensive explanation of all actions taken to resolve the matter.

**4-900 Section 9 --- Requesting Audit Guidance  
-- Regional Offices and Headquarters**

**4-901 Introduction**

This section states policies and procedures for processing requests to regional offices and Headquarters for expert advice, assistance, and guidance on significant auditing and accounting issues. Requirements for feedback to Headquarters on the application of guidance received are included.

**4-902 Obtaining Guidance**

**4-902.1 Definition**

For purposes of this paragraph, auditing and accounting issues mean any questions involving interpretation of the FAR and DFARS cost principles, Cost Accounting Standards (CAS), Generally Accepted Government Auditing Standards (GAGAS), Generally Accepted Accounting Principles (GAAP), or other applicable laws and regulations relating to the conduct of audits or allowability, allocability, or reasonableness of costs charged to government contracts.

**4-902.2 Background and General Responsibilities**

a. On occasion, field auditors require assistance and advice to help resolve new, unique, complex, or controversial auditing and accounting issues. Before issues are elevated for assistance the FAO, and if necessary the region, will research the issue thoroughly using the FAO and regional libraries. When the FAO's research does not adequately resolve the issue, a request for assistance should be submitted to the regional office.

b. When regions need additional audit guidance, their requests with supporting documentation should be submitted to Headquarters, DCAA, ATTN: P, 8725 John J. Kingman Road, Suite 2135, Fort Belvoir, VA 22060-6219 using the following format:

(1) SUBJECT. The subject line should always start with the following: "Request for Headquarters guidance on ..."

(2) Program Area. This paragraph should be identified as the major operational area.

For example: Forward Pricing, Defective Pricing, Comprehensive Labor, etc.

(3) Problem/Guidance Identification. This section should provide a clear and succinct statement of the problem, the guidance area for which the request is being made, and the anticipated use of the guidance.

(4) Regional Staff Evaluation. This section should provide: (i) the background which generated the request; and, (ii) the nature, extent, and sources used in the regional evaluation prior to submission to Headquarters. As appropriate, the related or background information should be referenced and included as enclosures to the request.

(5) Regional Alternatives. This section should provide any alternatives which the regional office may have identified for handling the situation and pro(s)/con(s) of each alternative.

(6) Regional Recommendation. This paragraph should identify the regional recommended solution with the supporting rationale.

(7) Regional Contact. Identification of the regional focal point, telephone number, and FAX number.

c. Headquarters researches Federal laws and regulations, FAR, DFARS, and CAS case history files, decisions of courts and boards of contract appeals, authoritative accounting literature, etc. to develop guidance. When appropriate, legal and/or technical input from outside experts or specialists is obtained.

d. Proposed guidance is coordinated with elements of the Office of the Secretary of Defense (OSD) when appropriate.

e. The feedback required by 4-902.3 below is used to evaluate whether further guidance is needed.

**4-902.3 Requirements for Feedback to Headquarters**

a. When a guidance memorandum is issued to one region, applicable to a specific issue at a particular FAO, advise the Headquarters division that issued the guidance of the application of the guidance. Regional offices will forward to the appropriate Head-

**January 2003**

**469  
4-902**

quarters division copies of audit reports, memorandums to contracting officers or others, or letters to contractors or others which reflect application of the Headquarters guidance.

b. Regional offices will also forward to the appropriate Headquarters division copies of any resulting contractor rebut-

tals, contracting officer comments, related legal opinions, or other comments received which: (1) could have an impact on the guidance previously provided, or (2) could lead to the issuance of a general memorandum to all regions and FAOs concerning the issues and related audit guidance.

#### 4-1000 Section 10 --- Relying Upon the Work of Others

##### 4-1001 Introduction

This section provides guidance for relying upon the work of others, except for government technical specialists. For guidance on relying upon the work of government technical specialists, see D-302.

##### 4-1002 General

a. An auditor's work includes the examination or development of sufficient, competent, and relevant evidence to afford a reasonable basis for his/her conclusions and recommendations. In examining or developing evidence, auditors may rely upon the work of others to the extent feasible once they satisfy themselves of the quality of the other's work by appropriate tests or by other acceptable methods. Work performed by another DCAA auditor is to be presumed of sufficient quality based on DCAA's managerial controls.

b. Documentation of work performed and evidence acquired or examined is maintained or referenced in the form of working papers. Working papers are the link between field work and the audit report. They should be complete and accurate; provide support for findings, judgments, and conclusions; and demonstrate the nature and scope of the work performed (see 2-306 and 4-400).

##### 4-1003 Work Performed by Others

An important source of evidence is work performed by other DCAA or government auditors, contract administration office staff, independent public accountants, contractor internal auditors and nonauditors. It is important to maintain effective communications with these groups, to understand their responsibilities, and to know when it is appropriate to request their assistance or rely upon their work. Coordinating with these groups can often provide additional audit evidence and avoid the duplication of effort. Following is a partial list of other sources of reliance:

a. Labor audits, floor checks, operations/IT/financial control audits, systems surveys, etc., performed by regional or other special DCAA audit teams.

b. Assist audits performed by other DCAA audit offices on subcontracts, offsite labor, etc., or on costs which are allocated from, or records which are maintained at, home offices, other divisions, segments, cost centers, etc.

c. Reviews performed by contract administration office staff on special cost-related subjects, procurement and inventory systems, etc.

d. Contractor internal audits and other self-governance functions (see 4-202 and 4-302.1b.(5)).

e. Reviews performed by the General Accounting Office or the Inspector General.

f. Reviews performed by independent public accountants (e.g., internal control audits conducted in conjunction with financial statement audits; see 4-302.1b.(5)).

##### 4-1004 Deciding Whether to Rely on the Work of Others

###### 4-1004.1 General Evaluation Criteria

a. Relying on the work of others reduces the amount of work necessary to accomplish audit objectives. The evaluation of the others' work is dependent on the exercise of sound professional judgment. The work of others has to be adequate to provide reasonable assurance that the DCAA audit objectives were accomplished. Care should be taken not to dismiss the work of others for some noncritical deficiency. In deciding whether to rely on the work of others, the DCAA auditor must first evaluate the competence, independence, and objectivity of the external and internal auditors, and the nonauditor. The DCAA auditor must then evaluate the individual work product for sufficiency. The DCAA auditor should also provide feedback to the contractor/external auditors on the results of our evaluations and the extent of our reliance.

b. Under self-governance programs, contractor personnel who qualify neither as auditors nor experts may be performing oversight functions in a given area. Such activities are part of the contractor's system of internal controls which should be assessed in planning the audit scope.

**4-1004.2 Evaluation of Competency, Independence, and Objectivity**

a. An initial assessment must be made of the professional competence, independence, and objectivity of the external and internal auditors and nonauditors. The results of this evaluation and documentation will be included in the permanent file, and should be updated as conditions change.

b. In order to eliminate duplicate inquiries, Headquarters will monitor the following national accounting firms regarding their professional reputations, qualifications, and independence: (1) BDO Seidman LLP; (2) Deloitte & Touche LLP; (3) Ernst & Young LLP; (4) Grant Thornton LLP; (5) KPMG LLP; (6) McGladrey & Pullen LLP; and (7) PricewaterhouseCoopers, LLP. This is not an exclusive list of public accounting firms that meet the Government Auditing Standard's criteria of professional reputation, qualifications, and independence. Rather it is an alphabetical listing of firms likely to be engaged by major DoD contractors. Regions and Field Audit Offices will be notified by Headquarters if problems with any of these firms are encountered. This Headquarters assessment does not alleviate the requirement for the DCAA auditor to evaluate the external auditor's work product and document that evaluation as discussed in 4-1004 and 4-1005. If reliance is to be placed on the external auditor's work, access is needed to the external auditor's working papers to perform the evaluation and documentation procedures. For other external auditors, determine that they possess the necessary competence and independence by obtaining a representation from the firm that they are (1) members of the AICPA and/or state society in good standing and (2) that the firm is independent under the requirements of the AICPA.

c. When an entity's internal audit department has adopted the standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors, the entity's internal auditors are likely to possess the requisite independence, competence and objectivity. The Standards include specific criteria for assessing independence, competence, and objectivity. A summary of the standards follows:

- Independence - Internal auditors should be independent of the activities they audit.
- Professional Proficiency - Internal audits should be performed with proficiency and due care.
- Scope of Work - The scope of the internal audit should encompass the examination and evaluation of the adequacy and effectiveness of the organization's system of internal controls and the quality of performance in carrying out assigned responsibilities.
- Performance of Audit Work - Audit work should include planning the audit, examining and evaluating information, communicating results, and following up.
- Management of the Internal Auditing Department - The Director of Internal Auditing should properly manage the internal auditing department.

Whether or not the entity's internal auditors have adopted these standards, the auditor should apply appropriate procedures to document that the internal audit department is competent, independent, and objective. Evidence should be readily available for review in the internal audit department.

d. Where appropriate, the CAC should coordinate an assessment of adherence to the above standards for the corporate managed internal audit function.

e. In determining whether an entity's internal audit department is competent, independent, and objective, the auditor should consider the following guidance:

(1) When assessing the internal auditors' competence, the auditor should obtain information about such factors as the educational level and professional experience of internal auditors, professional certification and continuing education; audit policies, procedures, and checklists; and supervision and review of internal auditors' activities.

(2) When assessing the internal auditors' independence and objectivity, the auditor should obtain information about such factors as the organizational status, including whether the internal auditor reports to an officer of sufficient status to ensure broad audit coverage and adequate consideration of, and action on, the findings and recommendations of the internal auditors. In addition, review policies to maintain internal

auditors' objectivity about the areas audited, including policies prohibiting internal auditors from auditing areas where they were recently assigned or are scheduled to be assigned on completion of responsibilities in the internal audit function.

f. The assessment of the internal auditor's independence, competence and objectivity should be used in determining (1) whether reliance can be placed on the internal auditor's work, and (2) if so, the extent of testing needed to evaluate the internal auditor's work product (i.e., less testing is needed if no deficiencies exist; increased testing is needed if deficiencies exist). In any case, the contractor should be notified of any deficiencies and the impact of those deficiencies on DCAA's ability to place reliance on the internal auditor's work.

g. For nonauditors (consultants, experts, specialists, etc.), other than those assisting in the audit, the auditor should consider (1) the professional certification, license, or other recognition of the competence of the specialist in his field, as appropriate, (2) the reputation and standing of the specialist in the views of his peers and others familiar with his capability or performance, and (3) the relationship, if any, of the specialist to the client.

#### **4-1004.3 Evaluation of Work Product**

a. To satisfy certain of the requirements discussed in subsections b through d below, access to working papers is required. Accordingly, make arrangements to ensure that working papers will be available. Evaluation of the work product should be based on a comparison of the audit steps the DCAA auditor believes are necessary to those which were performed. If the DCAA auditor concludes that audit program steps essential to developing evidence to support an unqualified opinion have not been performed, those additional steps must be performed by the auditor before issuing an audit report.

b. When evaluating the work of external auditors, consider whether to conduct additional tests and procedures, such as reviewing the audit procedures they followed and the results of audits they conducted (including their assessment of control risk). The auditor should review their audit programs and/or working pa-

pers, tests of compliance, and conclusions reached. The auditor may review the documentary evidence in the external auditors' working papers or make supplemental tests of the work conducted.

c. In evaluating the work of internal auditors, the DCAA auditor should examine, on a test basis, documentary evidence of the work performed by the internal auditors. He or she should consider such factors as whether the scope of the work is appropriate, audit programs are adequate, working papers adequately document work performed, conclusions reached are appropriate in the circumstances, and any reports prepared are consistent with the results of the work performed. The DCAA auditor should also perform tests of some of the work of internal auditors. The extent of these tests will vary depending on the circumstances, including the type of transactions, their materiality, results of prior audits; and the independence, objectivity, and competence of the internal audit organization as discussed in 4-1004.2 above. These tests may be accomplished by either (1) examining some of the transactions or balances that internal auditors examined or (2) examining similar transactions or balances but not those actually examined by internal auditors. The DCAA auditor should compare the results of his tests with the results of the internal auditors' work in reaching conclusions as to whether DCAA can place reliance on their work.

d. In evaluating the work of nonauditors, consider whether to (1) conduct additional tests and procedures (e.g., reviewing the procedures followed and the results of the work conducted), (2) review the work program, (3) review the working papers, (4) make supplemental tests of the work conducted, and (5) consider the methods or assumptions used.

#### **4-1005 Documentation Requirements**

a. Whenever reliance is placed upon the work of others, documentation is required. Reliance must be based upon specific knowledge of the actual work performed and the results obtained. It is not to be based merely upon the assumption or general knowledge that work is to be performed by others.

b. The extent of documentation needed is a matter of auditor judgment. However, there should be sufficient documentation to describe the scope of work performed, the period and costs/audit area covered, the nature and extent of audit procedures applied, the evidence obtained and analyzed, and the audit results. The documentation may include copies of working papers, audit programs, reports, third party confirmations, and DCAA auditor prepared summaries of the work performed. The documentation should also describe the extent of reliance that will be placed upon the work of others.

c. In rendering an audit opinion, consider all work performed, including that performed by others. If work of others is not sufficient in scope and as a result an unqualified opinion cannot be rendered, take steps to obtain additional evidential matter. Where the scope of work performed by other government representatives does not appear to be sufficient in scope, consult with the organization involved to obtain clarification or any additional information available. If reliance still cannot be placed on the work, advise the contractor of the need for additional audit work, how it relates to the work already performed by the other organization, and why it will not duplicate prior government audits. If additional evidential matter cannot be obtained, then render either a qualified or adverse opinion. See 9-212.2 and 9-212.3.

d. In determining the extent of documentation to be included in the working paper file, the auditor should apply the guidance contained in 4-406. To the extent possible, document reliance on the work of others by reference, notes, or extractions. Where a particularly sensitive or material audit conclusion hinges on other auditors' working papers and referencing/extraction would not be practical, include appropriate copies in DCAA working papers.

#### **4-1006 Referencing the Work of Others in Audit Reports**

##### **4-1006.1 Technical Specialists**

As indicated in D-300, refer to and give effect to technical findings and opinions when relied upon. See 10-210.3a and 10-

304.10 for suggested audit report comments when incorporating the results of technical review.

#### **4-1006.2 Part of an Audit Performed by Other Auditors**

a. The DCAA mission includes providing all contract auditing for the DoD, and providing accounting and financial advisory services to all DoD procurement and contract administration activities (see 1-102). Because DCAA has the ultimate responsibility to express an opinion on contract audit issues, judgments about assessments of inherent and control risk, materiality, sufficiency of tests, and other matters affecting the opinion must be judgments of the DCAA auditor. Recognition of the contractor's participation in self-governance should be included in the DCAA audit report in a manner which does not imply a limitation of scope or a qualification of opinion.

b. Ordinarily you need not make reference to work performed by another auditor if (1) the other auditor works for an organization associated with your organization (e.g., another DCAA office (see 4-1002a)) and whose work is acceptable to you based on your knowledge of the professional standards and competence of that organization; or (2) the other auditor is retained by DCAA and the work is performed under DCAA guidance and control; or (3) you take steps necessary to satisfy yourself with the other auditor's work; or (4) the work performed by the other auditor is not material to the opinion being expressed.

c. Once field work is complete, a report using the applicable format in Chapter 10 will be used. In addition, if another auditor's work provides relevant information to promote adequate understanding of matters being reported, the report may include:

(1) In the "Results of Audit" section, in additional comments:

- information on another auditor's work, including a brief statement on the purpose, scope, and a summary of results;
- a statement indicating if the other auditor's report has been provided to the PCO/ACO or is attached to the report;

- expression of appreciation for the participation of non-DCAA personnel in the audit effort (see 101-210.5d.(6)).
- (2) A reference in the explanatory notes accompanying the report exhibits, schedules, and appendixes to the other auditor's scope and findings as they relate

to the DCAA reported conclusions. Based upon the complexity and/or the nature of the findings, it may be appropriate to include the other auditor's report as an appendix. However, this should not be done without first obtaining authorization from the other auditor.